

Our ref: RJW/CEC20100308

8 March 2010

City of Edinburgh Council (as Financial Guarantor)
Waverly Court
4 East Market St
Edinburgh
EH8 8BG

Bilfinger Berger–Siemens– CAF Consortium

BSC Consortium Office
9 Lochside Avenue
Edinburgh Park
Edinburgh
EH12 9DJ
United Kingdom

Phone:

Fax:

For the attention of

- Thomas Aitchison (Chief Executive Officer)
- Donald McGougan (Director of Finance)
- David Anderson (Director of Development)
- Councillor Gordon MacKenzie

Dear Sirs and Madam,

Edinburgh Tram Network Project

For your confidential information, and without prejudice to the consortium's contractual rights, we write to you in your capacity as the senior representatives of the Council, which acts in the capacity as Financial Guarantor for the above project.

It is a source of considerable disappointment to this consortium that the entire Edinburgh tram project is not proceeding to schedule. At this time, the utility diversion works remain significantly delayed with no clear idea of when they will actually be completed or in what sequence. The direct and ongoing impact to our own works is significant, and this continues to bring further delays and considerable additional costs to the project. The consortium regrets that tie appears to be increasingly entrenched in its own position, unable and/or unwilling to address the realities of the situation in a constructive manner, and in apparent denial of the severe budget overrun that this project must face and resolve. Despite a number of ongoing initiatives from the consortium to seek a constructive solution to the issues, and to optimise the scope, time and cost of project delivery for the benefit of all parties, we deeply regret that tie still chooses not to engage with the consortium in any meaningful and constructive manner. This consortium is one of many parties to this project who are highly committed and driven to ensuring its success. However, we continue to be confronted by an ever increasing number of legal disputes with tie, all of which are burdening the parties with significant and unnecessary legal costs and senior management commitment, resulting in diversion from the very real objective of delivering a world-class transport facility in the most efficient manner.

We consider it to be both necessary and essential that we formally advise you, as financial guarantor of this project, about the actual current position relating to the cost and time overruns on the project, and also to put the record straight on the facts pertinent to the key principles which were independently established in the recent adjudications.

We also wish to express our concerns regarding both the level and the accuracy of information appearing in recent dialogue and correspondence from tie. This dialogue and correspondence makes some very serious accusations and representations of fact in support of tie's allegations, all of which are demonstrably incorrect. We are extremely concerned that this misinformation is giving a false and highly misleading picture of the current situation on the project, in particular where tie is alluding that this consortium is behaving unreasonably and may even be in formal breach of contract. This is not the case.

The consortium is also considerably aggrieved that it continues to make strenuous efforts to respect the project's confidentiality obligations at this time, but that incorrect and misleading background briefings are still being given to the media, many of which publicly smear and/or misrepresent the position of the consortium and its members.

It is an undisputed fact that the utility diversion works are significantly delayed. Despite repeated previous and current assurances from tie that these 'will be complete by summer 2010', we understand from reliable sources that some of these works may now not actually be completed before December 2010. The history of planning dates advised by tie to the consortium for the utility diversion works is a story of continual failure to deliver. The consortium is entirely sympathetic to tie's problems in procuring the completion of these complex works, but our contract clearly specifies that these works must be completed prior to the consortium being able to commence works in those areas. To have commenced earlier would simply cause further disruption at significant additional cost and with little meaningful progress – this was tried on Leith Walk, where even tie acknowledged that the additional interface problems encountered prevented any meaningful progress or benefit to the overall project.

From the first day tie has publicly sought to insist that it has signed a lump sum, fully fixed price contract with the consortium. This is not the case, as evidenced by the extensive list of defined pricing assumptions which form an integral part the contract, and also by the clear rulings of the independent adjudication process which fully support the consortium's legal and contractual interpretation.

It is not the consortium's view to consider the outcome of the independent adjudication process as being about 'winners and losers'. The process is about achieving clarity in relation to the contract, and about independently determining the cost and schedule implications related to the commencement and execution of the contract.

The three adjudications on the Contract wording to date have all been decided in favour of the Consortium's interpretation. The key dispute was the extent to which changes in the scope give rise to a contractual entitlement in favour of the consortium. The adjudications concluded that,

- the contract is a lump sum, fixed price (but only on the basis of its defined scope and programme), and that the contract is fully subject to the extensive pricing assumptions contained in Schedule Part 4 of the contract (ie. that the consortium has valid entitlement to be paid the additional costs of implications arising from any change to the scope and programme defined within the contract).
- pricing assumptions of Schedule Part 4 apply with priority, notwithstanding the contents of the Employer's Requirements or any other part of the contract between the parties.
- it is not for the consortium to prove that it was not in breach (rather that tie has burden to prove any breach it alleges).
- changes are deemed to have occurred when the contractual criteria have been met, and that this matter is contractually unrelated to the timely provision of cost estimates, which was ruled to be an entirely separate administration issue.

Prior to the adjudications, it was discussed with tie that the outcomes would be used as precedence for the analysis and speedy resolution of (many) similar disputes. To date tie has failed to acknowledge or accept these rulings, has given no rational justification for this position, and therefore continues to frustrate the timely resolution of other and related contractual disputes, resulting in further unnecessary delay and additional costs to the overall project. Tie appears to have identified that its application of the independent rulings to the similar disputes would directly lead to an 'absurd commercial position for tie' - to the extent that their projected costs for the entire project would then be significantly in excess of the total allocated budget available to them. This is not a rational basis under which tie should administer its obligations under the contract.

Another key ongoing area of contractual dispute concerns the 'change mechanism' under the contract, which specifically prohibits the consortium from commencing any works which are subject to a change without the prior agreement of tie. Tie has incorrectly accused Infracore of "*delinquent behaviour*" in this regard. The contract is quite explicit on this matter, and was specifically written in this way (at tie's insistence) to give tie direct control over the implementation of timing and expenditure of costs of any changes. Having so strongly insisted on this provision during the extensive contract negotiations, tie must acknowledge its responsibility to administer it accordingly. In reality, this is just not happening.

The consortium is extremely unhappy about the unfounded, and publicly made accusation of tie in relation to the consortium's alleged inflation of its cost estimates. As an example, and on the specific matter of the 'Russell Road Retaining Wall 4 Dispute', the original estimate was valued at approximately £4.5 million.

However, this estimate comprised three separate and distinct items, only one of which was referred by the consortium to adjudication. The actual amount in dispute was approximately £1.8 million, and tie's position was that this change was worth zero. The independent award was made for £1.46 million, with all principle issues being decided in favour of the consortium. The consortium fails to understand tie's continued insistence that the principles determined in this clear adjudication ruling cannot, or should not, be applied to the remaining and similar changes which are in dispute.

Within this letter we have attempted to set out our main areas of concern, but there remain many other issues on which the consortium is being misrepresented at this time. These include tie's unsupported and unfounded allegations that the consortium has failed to mitigate the delays which tie has caused to it. To the contrary, the consortium has sought to mitigate additional cost wherever practicable and for the benefit of the project. This has been no easy task in circumstances where there is no meaningful agreed programme, where tie has failed to acknowledge the many changes which have occurred, where tie has failed to provide access to the site, or to administer the contract in a professional and efficient manner.

The Edinburgh Tram contract was negotiated over many months between large organisations, all of whom had considerable professional advice. As experienced international contractors we anticipated and planned for the special risks involved in this project. The final contract reflects the specific agreement and understanding between the parties not to commence site works on an inner city tram network prior to the full completion of the utility diversion works. The consortium believes that tie must acknowledge that it fully accepted these and other risks as enshrined in Schedule Part 4 of the contract. In this regard, it can no longer continue to hide behind the invalid argument that the contract is a lump sum, fully fixed price. Having accepted the cost increases associated with the delays and changes, tie must either make provision to have sufficient funds available, or review the project scope with respect to defining a reduced scope which can be met within the available budget constraints. The consortium has already proposed a number of ways in which it could assist tie to make these decisions. Subject to retaining its contractual rights, the consortium has even indicated a willingness to discuss more radical options for the reprogramming and/or restructuring of the works, even (on a without prejudice basis) outside of the existing contractual framework. The consortium remains extremely disappointed that tie has to date made no constructive moves to engage with the consortium in addressing a 'best for project' solution.

One particular option is in how to deal with the complex and extremely sensitive inner city works (On-Street works). For more than six months the consortium has sought to negotiate and agree a constructive and economic solution. tie has chosen unilaterally to terminate these discussions just at a time when the consortium considered that an agreement could be reached which would have enabled works to progress immediately and at the same time would have substantially resolved a large number of disputed items. This action is particularly surprising since the critical Princes Street works were carried out in 2009 under

an almost identical arrangement which proved highly successful with the works being completed ahead of time and under an open and transparent cost framework.

At this time it remains very difficult for the consortium to accurately predict the total additional costs to the project. This is primarily because of the ongoing and uncertain utility diversion works delays and completion schedule. However with more than 500 notified changes issued to date, the costs will be considerable. In addition the consortium has clear entitlement to time related costs arising from the extension of time to which it is entitled.

For your confidential information, and without prejudice to the consortium's contractual rights, we are obliged to inform you that we currently assess the project to be approximately two years in delay, equating to a revised contractual completion date around November 2013. Even allowing for a very conservative application of the existing independent adjudication rulings to other similar disputes, summed together with actual incurred time related costs, the consortium would today estimate the likely additional costs to our contract to lie in excess of £100 million.

It is in the interests of none of the project parties to generate and become involved in protracted legal disputes. This always results in consumed senior management time and inevitable high legal costs which no party ever fully recovers. We can be sure that the consortium is well advised on its position by a number of eminent legal entities and by Queen's Counsel. The strength of the consortium's legal arguments will certainly prevail after a lengthy and costly litigation process. This would undoubtedly bring further delay and cost to the entire project and is an outcome that we would sincerely wish to avoid. However, it does concern us that the current position of tie has recently become more threatening and irrational, suggesting a more drastic action on their part. There is no valid legal basis for tie to instigate a default termination of the contract at this time. If, for whatever reason, tie were to instigate such an action, then the consortium and its partners would not only defend their position with vigour, but would also proactively instigate legal counter-actions. In such circumstances the consortium would no longer feel obliged to continue accepting unjustified public criticism and smears of its position and would proactively instigate appropriate measures to ensure that the true position was properly and openly represented in the media.

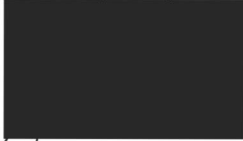
However, the consortium's primary interest at this time still remains focused upon finding a consensual approach with the other project parties, one which will enable the project to proceed with a defined scope and within an appropriate and available budget. We remain fully open to contributing towards finding and implementing the optimal project solution, and we remain fully prepared and available to actively discuss a full range of options to take the project forward with all relevant parties. We have even indicated willingness, on a without prejudice basis, to discuss potential solutions with tie that may lie outwith the contemplation of the existing contract, if tie believed that such action might be to the overall benefit of the

project. Notwithstanding this commitment, it must also be clearly noted that the consortium has certain clear rights and entitlements under its existing contract, and should reasonably expect these valid entitlements to be properly addressed and resolved in a timely manner.

We believe that the historic city of Edinburgh is worthy of a first class, modern and efficient tram system, delivered at an optimal but realistic cost. We trust that you will continue to actively support this project, and will be able to give comfort to the involved parties, including ourselves, who are most concerned that the current allocated funding for the project appears quite unrealistic in comparison to the reality of the anticipated total costs at this time.

We remain fully available to answer your questions on the above as you may consider appropriate.

Yours faithfully,



R.J Walker
Chairman - Infraco Consortium Board

- cc. David Mackay – Transport Edinburgh Limited
Richard Jeffrey – tie Limited
Graeme Bissett – tie Limited
Michael Flynn – Infraco Consortium Board (Siemens)
Antonio Campos – Infraco Consortium Board (CAF)