Tram Project Board: December 2005

Project Director – Trams (TPD) Executive Summary

1. TPB Project Governance:

TPB is to note that a paper substantially outlining a recommended way forward was presented to the TEL Board on the 22nd November, 2005. No substantive discussions took place and have not since taken place.

TPB is requested to review the Tram Project Governance TEL & Service Integration full discussion paper and having reviewed it to provide views to the TPD at the meeting. The discussion paper is released to Board Members as part of this pack.

Matters arising: ____________________

Included for discussion is a paper which Outline Business Plan For TEL paper which puts some structure around the overall TEL business planning process.

Matters arising: ____________________

Both of the above referenced papers are **tie** papers following consultation with TEL.

The TPB should note that joint office accommodation is being written into the 2006/2007 **tie** budget for co-location of TEL with tie.

tie is adding the costs of developing the business plans for TEL into its 2006/7 budget.

2. Funding/Delay:

TPB is to note that continued funding of the tram project parliamentary process has been verbally agreed between the SE and **tie** and the CEC awaits confirmation. This is in the sum of £1.61m. This confirmation was to transfer from Implementation Budget rather than "new money" which was expected.

TPB is to note that funding commitments for the tram project are required to secure the best response from the market for MUDFA, INFRACO and TRAMCO. TPB is to note that the INFRACO and MUDFA markets are made up of substantially the same organisations.

SE advises that detailed meetings between CEC and itself are programmed to occur over the next few weeks. SE also advises that final determination of indexation and CEC commitments will be made known and every effort to resolve before Christmas will be made.

TPB should request details of progress made by the SE/CEC.

TPD seeks authority to progress in line with the attached paper "Tram Project Funding" in preparation of contract documentation.

Approved:____________________

TPD advises that the delivery of the utilities agreement is on the critical path for the project and that delays in reaching agreement beyond the anticipated tender release date of 9th January, 2005 will add cost to the total project value at a rate of circa £3.5m per month.

TPD advises that the proposal included in the "Tram Project Funding" paper is to delay in-street utility diversions works until end-September and that a three month overall programme delay will arise. TPD will look to minimise this but TPB should note that 3 months equates to increased costs of £10.5m. Acceleration costs in the same order are achievable within MUDFA to hold the Scheduled Opening Date. There is little to no doubt that restrictions on public utilities diversions will have to be minimised consistent with acceleration.

Approved:______________

3. PQQ Results for MUDFA

tie has completed the evaluation of MUDFA bidders and is finalising its report.

The identities of the four pre-selected MUDFA bidders will be issued to the TPB.

Given a funding agreement between the SE and the CEC is achieved the tender release date for MUDFA is 9th January, 2006.

TPB assistance with Scottish Power may be requested – to be advised at the meeting.

4. OJEU for Infraco:

The OJEU for the Infraco will be released on 19th December, 2005.

5. JRC and Financial Modelling:

JRC modelling is a critical input into the alternative TEL business plans, risk management strategy and financing agreements with SE and CEC.

TPD has authorised a Change Request to accelerate the modelling production and awaits JRC confirmation. £110,000 has been added to the 2005/6 Implementation Budget in anticipation.

TPB to authorise TPD to agree to acceleration costs of up to £250,000.

Approved:_________

All models will be capable of handling alternate modes permitting alternate service integration patterns.

TPB is advised that multiple sensitivities will be necessary for each phasing option.

TPB is advised that final selection of phasing and service pattern will not be undertaken until end-September, 2006 based upon affordability.

TPB is advised that alternative bus service patterns have been produced by Transdev which address for each of the three main project options alternative potential solutions for discussion. These alternatives are now ready for input into TEL and production of alternative TEL business plans.

TPD advises that further work continues.

6. Safety Plan & Issues:

TPD has initiated the development of Safety Management improvements.

TSS has been appointed as Planning Supervisor under CDM.

TPD has initiated development of the tie Corporate Safety System utilising TSS resource.

TPB is advised that there have been no LTI's on the tram project in the last month.

TPB is advised that tie has not resolved the issue of Safety Director and Executive Directors. **tie** remains outside of normal corporate practice for a project management firm. Revisions in the Corporate Safety System have been instructed in line with normal corporate practice in anticipation.

7. Tram Project Accommodation

TPD has initiated discussions with TSS to provide office accommodation in Buchanan House, Glasgow. This will facilitate improved communications between the tram project and Network Rail.

TPD has initiated discussions with SDS to facilitate co-located **tie,** TSS and SDS project staff outwith **tie's** corporate office in Haymarket. Adjacency is considered critical to the performance of the tram team.

A solution and Change Order(s) are being progressed and will be presented by TPD when a solution is determined. The target date for resolution of this is January 2006.

Approval from the TPB is requested for authority to vary the SDS agreement in the sum of up to £1.85m (all in costs) to require SDS to enter into a 5 year lease for space for up to 100 staff with **tie** to act as surety for the change.

SDS contract requires PB to mitigate demobilisation costs and this is the best risk managed position for **tie** to adopt.

Approved:______________

Tram Project Governance

TEL and service integration

Background

This note recommends a way of managing the relationships between the parties with an interest in the Tram project. The objective is to deliver a successful tram system as part of an outstanding integrated transport service for the people of Edinburgh. The challenge is to ensure that we move ahead on a basis of clear accountability, avoiding duplication of effort and ineffective decision-making processes. The note reflects discussions with a number of the principal parties since the last TEL Board meeting.

Nothing in this document should be interpreted as seeking to change CEC's primary role throughout the anticipated process as Transport Authority.

Summary

There are broadly three scenarios. The first involves a phased development of TEL's role and responsibilities and is the one most parties favour. In the period to Financial Close, TEL takes overall responsibility for three areas : 1) developing the optimum integrated service pattern ; 2) coordinating communications with stakeholders and media ; and 3) overseeing integration dialogue with third party operators. After Financial Close until commissioning, TEL is the principal contracting party for the system construction and vehicles contracts while tie acts as TEL's representative to project manage the delivery of the system.

The other two scenarios are : a) tie continues as the pivotal entity until commissioning in 2010, with TEL acting in an oversight capacity ; b) the tram activities and people within tie transfer to TEL at an early stage, tie has very limited further involvement as a company and TEL takes on tie's legal and contractual responsibilities. For various reasons explained in this note, neither of these options will be as effective as the phased development scenario.

If the phased approach is followed, it is necessary to preserve the newly-developed governance model while ensuring TEL is fully incorporated. From now on, TEL has substantive responsibilities for service integration and communications. The proposal is that TEL reports progress on its activities, through the TEL CEO, to the Tram Project Board until Financial Close. The TPB is the agreed forum for resolution of all project matters, with resort to the tie Board or CEC only exceptionally. TEL meetings are the appropriate forum for debate and resolution of integration related matters.

Structure and contents

The note sets out the following :

1) Summary of parties and roles
2) Project programme – main milestones as background to TEL development options
3) Objectives of the service integration process
4) Options for TEL development, focussed on the phased approach and including a review of the detailed steps necessary to execute this approach
5) Composition of the Boards of the main entities
6) Summary of other matters to be addressed
7) Summary of suggested next steps.

An Appendix sets out :

I) Detailed pros and cons of the tie- and TEL-centric options

1) Parties and existing structure

The parties are :

- City of Edinburgh Council
- Scottish Executive
- TEL
- Tie
- Lothian Buses
- Transdev/TETL

It is assumed that both Bills receive Royal Assent in Q1 2006.

The current governance model is :

- CEC – Sponsor, part-funder, ultimate decision-maker dependent upon funding agreement from SE
- SE – principal funder
- Tie Board – legally responsible for tram project delivery, under instruction from CEC
- Tram Project Board – responsible for overseeing execution of tram project delivery
- Tie Project Director and team – responsible for tram project management and delivery

2) Programme

The programme breaks down broadly as follows :

December 2003	Tram Bills submitted covering full scope of Lines 1 and 2, supported by estimated capital costs and advisor-led operational definition
May 2004	Transdev contracted to support operational development of tram
2004 - Oct 05	Limited service integration dialogue between the parties ; substantial progress on tram project parliamentary process, delivery team definition (including supporting contracts), some key funding aspects and forward programme definition ; project governance model redefined.
Oct 2005	New TEL Board formed
Nov 2005	Commencement of market consultation, system/vehicles tender definition and detailed updating of patronage/revenue estimates
Spring 2006	Royal Assent, both Bills
Summer 2006	Approval of OBC, tender issue
Autumn 2006	Capital cost clarity from response to tenders ; patronage / revenue clarity from JRC modelling work ; finalisation of TEL business plan including optimum service integration model ; scope and funding decisions to be taken
To mid 2007	Negotiation of preferred bids to Financial Close
2007-10	System construction, pre-commencement mobilisation, marketing and public communications
Mid 2010	New integrated system commences with operation of tram

This provides the background to the roles of the parties.

3) Objectives

In relation to the development of the integrated service model as part of the overall project, the following objectives need to be addressed effectively by the proposed governance and management arrangements :

A. The existing tram project governance model has the approval of SE and the changes we are now discussing must augment its robustness
B. We have not yet had an effective forum for assessing the full implications of service integration and this is now a critical path item on the way to final decisions on scope and funding of the tram network.
C. Although some of the parties have specific commercial interests and responsibilities – notably LB and Transdev – it is necessary that these do not impede project progress. Any air of mistrust between the parties must be dispelled and a genuine collaborative approach established.
D. The detailed patronage and revenue projections will be critical to ultimate scope and funding decisions. The projections must reflect the most up to date transport movement and demand information available, must involve all key parties in their development, must expose all key assumptions and their effects for evaluation and sensitivity testing, must incorporate an effective integrated ticketing model, must take account of the long-term nature of the project, and the output must pass an educated sanity check. In addition, the JRC model will form the basis of target revenues and costs under the DPOFA contract, which will require separate negotiation and agreement. These are challenges for the JRC modelling process which is being project managed by tie but which involves all relevant players with full transparency of inputs, process and outputs.
E. Public communications are critical, especially during construction and there is a clear need for announcements and comment to be planned, professionally managed and coordinated as a "single voice"
F. The structure must also be capable of evolution to suit the changing needs of the whole project and must make the best use of the experience and talent around the table in all phases.
G. The structure must fully comply with the letter and spirit of competition law, transport legislation and all other relevant rules and regulations ; taxation must also be integral to planning.
H. The requirements of both CEC and the Executive must be fully recognised throughout.

4) Options

There are many options and many have variants, but I would suggest there are three principal models :

- Scenario 1 – a staged migration of overall responsibility to TEL as the pivotal entity, but which requires TEL to play a substantive role from this point on.

- Scenario 2 – which leaves tie in full command of all aspects of the project and leaves TEL in an overseeing role only.

- Scenario 3 – transfer of all tie responsibilities, people and contractual arrangements to TEL, positioning TEL as the pivotal entity from this point on and removing tie (as a company) from the project

Scenario 1 is my recommended approach and is described in more detail below. It fulfils Objective A above. Diagrams showing the migration of roles are also provided.

I have provided less detail on the two alternative scenarios because I believe the flaws are fairly obvious. However, if people disagree we can try to develop the structure further. The analysis of these two options is in Appendix 1.

Scenario 1

The principal components are :

1. TEL immediately takes the role as Client for the production of rigorous analysis of the service integration options and the activity required to produce them. This fulfils Objective B above. TEL would have three principal responsibilities in the period to Financial Close :

    I. Ensuring that all parties – especially tie, Transdev and LB – engage constructively and provide all the information necessary to achieve a rigorous outcome to the design of the optimum integrated system. In particular, 1) that conflicting commercial interests are addressed and equitable solutions to conflict are implemented at the right time, dealing with Objective C above ; 2) that tie manages the JRC modelling process in such a way that all relevant involvement is achieved and that the detailed output objectives described under Objective D above are delivered ; and 3) that reasonable and rational positions are taken on operational matters such as junction priority and design. TEL is therefore in a position to manage the creative tension inherent in designing a “merger of two businesses”, tram and bus.

II. Developing a communications plan for all stages of the project. In the short term, tie and LB may continue to handle tram specific and bus-specific communications respectively, but protocols are needed to ensure that a coordinated approach is adopted where common sense dictates that this is best. The role of CEC's corporate communications team needs to be considered. There is a school of thought that says the sooner we move to a fully integrated communications approach the better. A further consideration might be whether another TEL NXD appointment is merited for an individual with marketing & communications expertise. This fulfils Objective E.

III. Managing contacts with third party transport operators to widen the scope of integration planning, in accordance with Competition law.

2. In late 2006, TEL plays a key role in the dialogue with CEC and SE to determine final scope and funding decisions. This will incorporate the optimum service integration models and the tendered capital costs / capital funding sources.

3. TEL becomes fully acquainted with the terms of the construction and vehicle contracts and the SDS contract (collectively "the Systems Contracts") in preparation for step 6, when TEL becomes the legal contracting party. TEL will require to be credible for this role to the construction market.

4. Tie continues to lead procurement of the tram Project, reporting through the governance structure currently in place. This includes execution of the procurement strategy, assessment of land and property acquisition activity, utility works and system design ; these responsibilities also require collaboration with other parties and cognisance of the emerging picture on capital costs and revenue modelling.

5. TEL reports on its service integration responsibilities through the existing governance structure, to the Tram Project Board. This is possibly an undesirable complexity, but there must be a single forum where all issues are coordinated. In the period before Financial Close, the tie Board retains ultimate legal responsibility for the project delivery, reporting to its client CEC. This order of legal precedence must be recognised and accepted by all parties at the outset. In summary, through to Financial Close the ultimate legal responsibility continues to rest with the tie Board ; in the event that any dispute arises between TEL and tie, the Project Board is the obvious forum for rational debate. If there is a failure to reach agreement, the ultimate decision-maker is of course CEC, who will require to respond to the views of SE on most fundamental issues. That said, the close working relationships being developed should avoid any such impasse among the operating companies, but a mechanism is required in case.

6. As of Financial Close, the model becomes simpler. TEL becomes the Client for the Systems Contracts. TEL has overseen the preparation of the optimum service integration model and will have confirmed the construction scope, costs and funding. This forms the basis of TEL's cash flow planning and would be embodied in a TEL Business Plan at that point. Tie is simultaneously established, by contract between tie and TEL, as TEL's Client Representative, responsible to TEL for the Project management of construction. TEL is responsible to CEC for all aspects, rather than tie. The Project Board may need to be redesigned, but will now report to TEL and not tie.

7. TEL would take over the direction of LB and Board changes would be necessary to make this work properly, with LB effectively becoming an "operating division" of TEL during the construction period and thereafter once the integrated system is operational. This will provide unified planning and operation of the LB bus network and will also facilitate pre-launch marketing and public communications. Ideally, this would be the point to transfer the shares of LB to TEL, supporting the "single economic entity" structure under TEL. However, the tax planning aspects require further work prior to transferring the shares and transfer may require to be delayed. Handling the changes to the Board and share ownership of LB requires sensitivity and further consideration is needed to get the planning right.

8. In accordance with the timetable envisaged in the DPOFA contract between tie and Transdev, the contract would novate from tie to TEL immediately prior to commencement of tram operations. It may be appropriate to novate the DPOFA as at Financial Close, again an issue which should be further addressed.

9. In the period following operational commencement, tie would have a continuing role in reliability testing, claims resolution and maintenance management. This can be executed as agent for TEL and longer term, TEL could take over the maintenance management role and indeed all aspects of integrated system operation.

10. An additional dimension which may require dialogue between TEL and CEC is the extent to which strategic transport matters are delegated from CEC to TEL over the next five years. For example, it might be conceptually appropriate to have TEL responsible for all mode integration matters, related schemes such as Park & Ride, involvement in major interchange planning such as Haymarket and Waverley Stations. I have not taken this any further at this stage but the logic is strong.

Objectives F and G are met by the changes to structure described in the migration plan above, especially steps 6,7 and 8. The proposal also appears to meet all legal and tax planning objectives, though some further work is needed to confirm this. Objective H – full coordination with CEC and SE – is already embedded in the governance structure and would be a rolling feature.

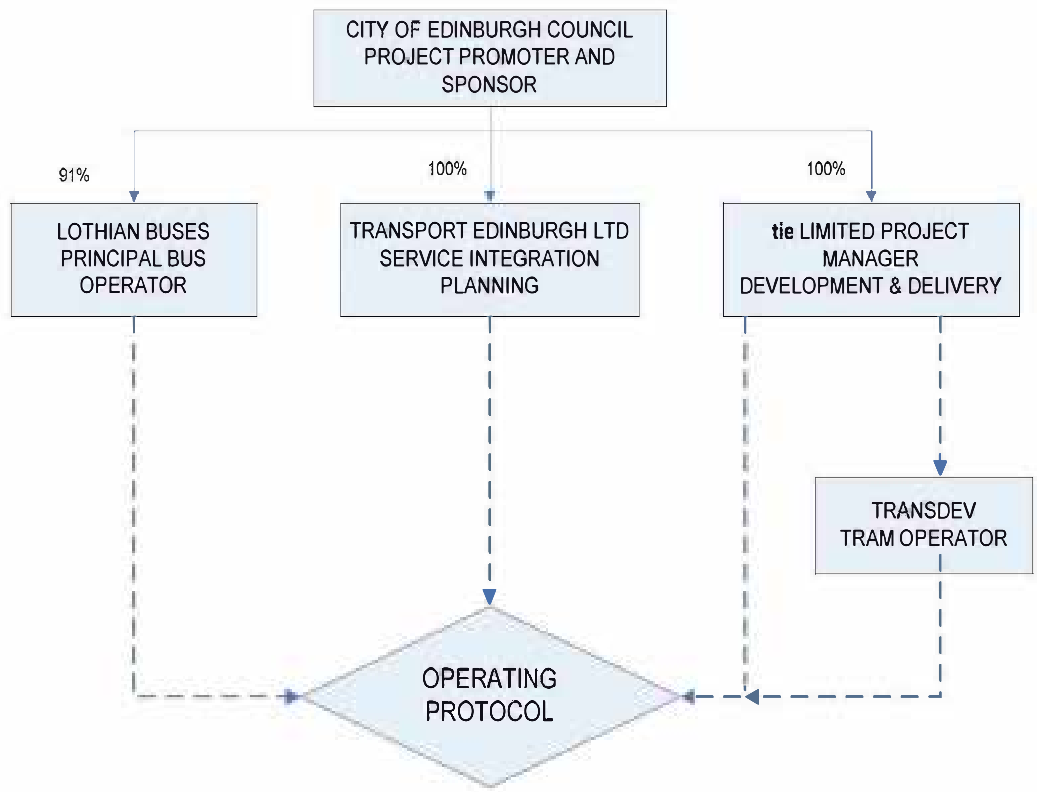
The Boards of tie, LB and TEL have fiduciary duties to their shareholders and to creditors. The fiduciary duties extend to proper stewardship of each company. In view of the integrated nature of the activities of the three companies, it seems that the actions described above would fit with the concept of proper stewardship, because each entity has clearly defined responsibilities, which will be approved by its shareholder.

The most fundamental responsibility is financial stability. At present, tie is properly funded and has specific budget allocation to handle anticipated TEL spend in the current year. Costs already picked up by LB can be reallocated. If the activities of TEL are focussed on service integration as outlined above, subsequent funding awards for 2006-07 from SE (and partly from CEC) will cover the costs. Accounting mechanisms can be installed to match spend / funding with the right companies. Once we are agreed on the corporate structure and responsibilities, it will be possible to set up accounting mechanisms to match spend / funding with the legally responsible entities. The funding application for the next tranche of tram funding will spell this out in detail.

The following three pages show the formal relationships in the three main stages of the project :

1. Through to Financial Close
2. Financial Close to commissioning
3. Operations

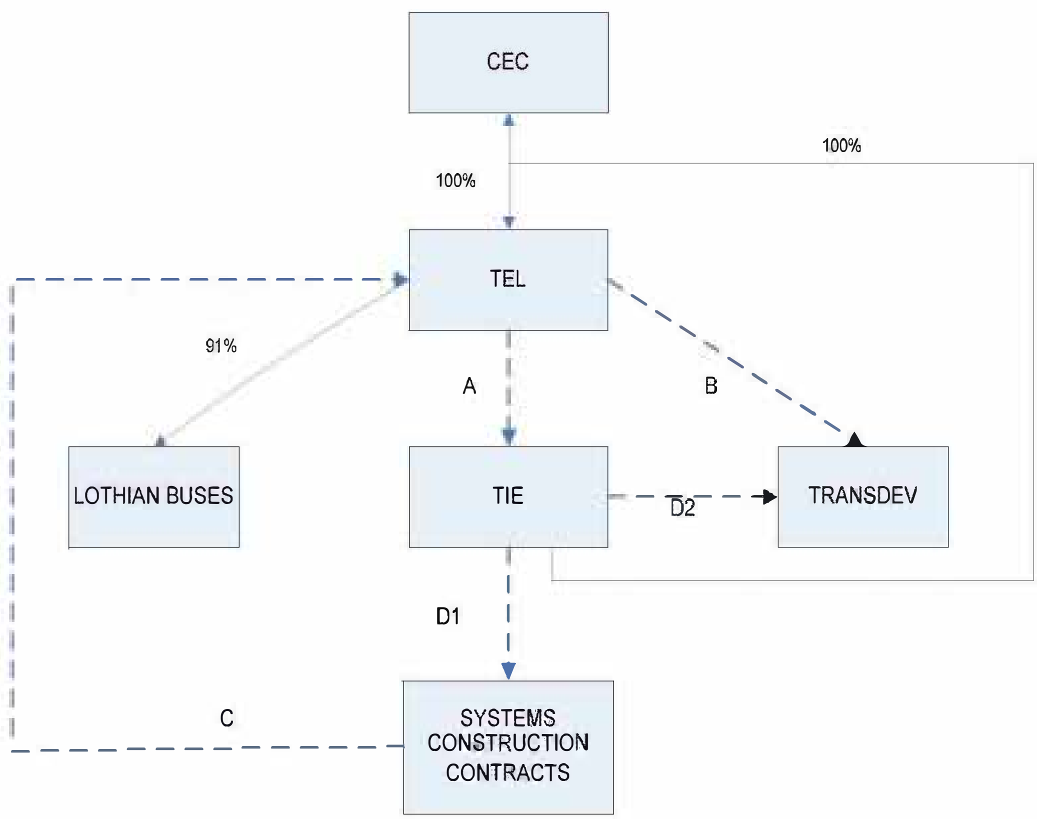
1. FORMAL RELATIONSHIPS AND ROLES OF MAIN PARTIES IN PERIOD TO FINANCIAL CLOSE



Each subsidiary is regulated under a Shareholder/Operating Agreement with the Council.

Unbroken lines represent ownership
Broken lines represent contractual or semi-contractual relationship. Between tie and Transdev this is the DPOFA. The Operating Protocol is required by CEC and will be designed to codify the service integration activities for which TEL is responsible.

2. FORMAL RELATIONSHIPS AND ROLES OF MAIN PARTIES IN PERIOD FROM FINANCIAL CLOSE TO COMMISSIONING



A – Contractual client relationship to project manage delivery

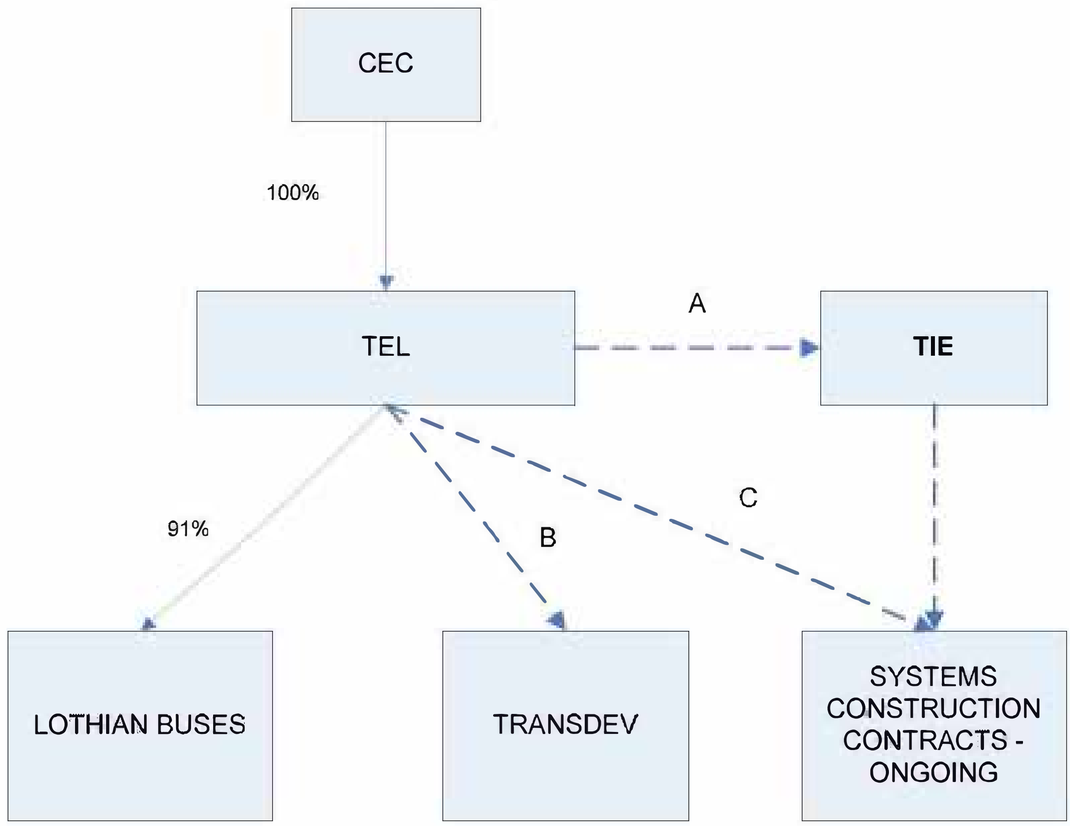
B – DPOFA (Novated)

C – Principle client Systems Contracts relationship including construction, vehicles, SDS

D – Contract project management relationships

Assumes LB shares transferred to TEL at Financial Close.

3. FORMAL RELATIONSHIPS AND ROLES OF MAIN PARTIES FOLLOWING COMMISSIONING



A – Contractual client relationships to handle reliability testing, claims resolution and maintenance management. This will probably require a contractual relationship between tie and the systems contracters to effectively project manage these relationships, similar in principle to the construction period

B – DPOFA

C – Principal contractual relationship for ongoing obligations

In summary, Scenario 1 would lead to the minimum disruption to existing governance structures and responsibilities, but would allow TEL to take on a substantive role in the period to Financial Close, including leadership of service integration planning, communications / marketing planning and third party operator integration. At Financial Close, TEL will require to be prepared to take up the pivotal responsibilities in delivery of successful operations, while tie remains in its primary role of project deliverer. Transdev have a key role in all aspects through their existing contractual relationships. During construction, TEL will be in a position to ensure that all parties hold to decisions made in support of Financial Close and could arbitrate on any disputes which may arise.

Scenario 1A

A variation on Scenario 1 - call it 1A - would follow the same path until step 5 above. Then the Systems Contract relationships are vested in tie, rather than TEL, with tie continuing to have primary responsibility for all aspects to CEC. However, this would fail to build on the momentum developed within TEL and would leave TEL's role somewhat in limbo until mobilisation some 2.5 years away. No doubt a governance structure could be defined which would work, but this seems less attractive than Scenario 1.

5) Board composition and attendance

It is desirable to have a balance between cross-representation, which promotes mutual understanding on issues ; and independent thinking on the part of each entity. The Boards to be addressed are TEL, tie, LB and the Tram Project Board. There are many options and I suggest that the NXDs might have a separate discussion about the appropriate composition. At first sight, the attendance by Execs / operators and observers seems to have most of the right people around each table. There is real challenge in dovetailing agendas and a clear desire to streamline the meetings avoiding duplication of debate. This should again follow agreement on the right model and membership. Finally, in assessing any changes it may be appropriate to focus on active attendance at relevant meetings rather than formal statutory board membership.

The current picture is :

	tie	TEL	LB	TPB*
Members				
Chair	EB	AB	PS	GG
NXDs	GG	WG	WG	MH
	JR	DM	Others	GB
	JB/NEW			NR
				IK
	AB			AW
	MC			DS (Sc Ex)
	BC			AH (CEC)
	ANO **	ANO**		
Execs / operators		NR	NR	
		WC	WC	
		MH	NS	
			Others	
		KR (CEC)		
		AW		

* Not a statutory board
** Anticipated that a non-Labour appointment will be made shortly

	tie	TEL	LB	TPB*
Attending/ observors	MH	IK		
	DS (Sc Ex)	GB		
	AH (CEC)	SMcG		WG
	IK	NS		DM
	GB	RA		
	NR	JD***		
	JP (PUK)			JP (PUK)
	Others as required	Others as required		

*** Secretary

(yellow)	On all 4 Boards, or attending	NR
(cyan)	On TPB, tie, TEL	MH, IK, GB
(green)	On TPB, TEL, LB	WG

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6) Other matters for discussion

1. There is a need to capture the activities in proper business plans :
    a. TEL 2005-06 : Period to 31.3.06, containing a brief summary of activities, noting that there is no significant TEL-specific expenditure, such costs as arise will be met out of previously agreed budgets held by tie. Note that JRC costs are significant, but are budgeted within tie and funded by SE / CEC
    b. TEL 2006-07 : This will need to respect the financial year end of 31.3.07, but would be most usefully taken forward to Financial Close. This should capture activities and costs, and where appropriate identify costs borne by other parties especially tie. This plan needs to be dovetailed with that of tie for the same period and be directly related to the funding request to SE / CEC which will follow.
    c. Documents a and b are mainly to fulfil CEC reporting requirements and to support specific funding requests. These documents should be prepared for approval by the TEL Board in December, in line with tie's reporting cycle. The plans will be formally approved by CEC in February, by which time the funding requirements should be agreed.
    d. A broader ranging "Integrated Service Business Plan" sponsored by TEL should be compiled to capture all of the programmed activity through to commissioning and beyond. This can also be targeted in draft for December's TEL Board, once the TEL development model is approved at the November meeting.

2. The "Transport Edinburgh" name and brand is being used to front a number of CEC transport related schemes and documents. How this is squared away with the vital, but more closely-defined responsibilities for service integration needs addressed. If TEL is to be re-launched, there should be clarity in the public mind about its role.

3. TEL will require advisory support as it develops. We will want to avoid duplication with tie's advice in relation to the tram project to control cost (there is currently no budget provision for an additional legal firm's involvement) and also to ensure progress is made. Assuming Scenario 1 is followed, the following requirements emerge :

    Legal :
    - Review of Systems Contracts (construction and vehicles) pre-tender issue - March 2006
    - Review negotiated amendments to Systems Contracts - Q4 2006, Q1 2007
    - Overview of pre-existing contracts with continuing effect (SDS, JRC, MUDFA) - Q4 2006, Q1 2007

This should be a review of the detailed drafting and negotiation work led by DLA, rather a separate drafting process. A duty of care and engagement letter between TEL and DLA has been operating and could be refreshed. The objective is to put the TEL into a position of full knowledge and comfort that the contracts TEL inherits at Financial Close are sound. A procurement process for a third party firm commencing in late November should produce a result in this timeframe.

Now that the incorporation matters are completed, there might be merit in TEL utilising D&W as company secretary, as tie does. The cost of this is minimal in line with the scope of work involved, but ensures all legislative requirements are met. CEC Legal would be involved as appropriate when amendments to Board composition etc are to be implemented.

Financial :

- Modelling support to arrive at integrated system financial projections to support scope and funding decisions - mainly Q2, Q3 2006
- Monitoring tax implications of LB share transfer - ongoing and will involve also tax advisers to CEC and LB.

I would recommend that both tie and TEL use PwC for this work ; the need for <u>independent</u> financial advice is less than that for legal advice.

4. Given TEL's unifying role and need for expanding team members over the next few years, an appropriate cost-effective office independent location might be appropriate.

5. There will be intensive work between teams from different organisations in the period ahead. Consideration might be given to intelligent team-building activity to support this. This would be aimed at developing good working relationships and understanding of respective interests. It need not involve leaping off telegraph poles in the dark.

6. The role of the TEL CEO needs to be defined to facilitate separation of activity from that of his LB activities

7) Next steps :

Nov / Dec 2005

- Scenarios to be discussed at the TEL Board on 22.11.05 – follow up dialogue as necessary
- Board composition and agenda management to be addressed dependent upon model adopted
- Competition and other legal aspects to be revisited in light of model adopted
- Tax planning ditto including LB share transfer and position of LB minority interests
- DPOFA legal interests to be reviewed to ensure fully taken into account in agreed TEL migration plan
- When agreed, regardless of model, it will be necessary to develop the three business plans described above. The detailed workstreams which comprise the "Integrated Service Business Plan" and the terms of the Operating Protocol will be a matter of urgency. In addition, CEC also require an Operating Agreement to be put in place between TEL and CEC and this should follow the decisions made on TEL's role and responsibilities.
- Advisory appointments as deemed necessary

- Dec Board to approve :
    - Final TEL development model
    - Integrated Services Business Plan including detailed workstreams
    - Operating Protocol between all parties
    - CEC / TEL Operating Agreement
    - Business Plan for 2005-06
    - Draft Business Plan for 2006-07

APPENDIX 1 – ALTERNATIVE MODELS

Scenario 2

This is really a purer version of 1A. The essence is :

- Tie, within the existing governance structure, takes all responsibility for delivering the project outputs described above (leave aside point 10 for now) through to the latter stages of construction.
- TEL oversees integration activity but has no direct role, possibly other than dispute resolution. The same outputs from integration activity are obviously required as under Scenario 1.
- There is no need for parallel Systems Contract evaluation because tie will be the contracting party, continuing to report to CEC direct.
- Similarly, TEL has no need to engage with the tenderers as it will have no direct responsibility during the construction period.
- The migration of control of LB from LB to TEL could take place at (say) Financial Close, including Board changes. At or around commencement, TEL would acquire the shares in LB, and the DPOFA contract would be novated to TEL.
- Tie would have the same post-commencement responsibilities as above.

The benefits would include :

- Continuation of tie's current central role, avoids need to manage interface between tie and other entities
- Allows tie to interface with contractors, more limited need for a new entity (TEL) to be involved

The flaws include :

1. The project would be denied TEL's ability to provide a unifying approach to integration planning, which all individual parties will struggle to emulate. Under this Scenario, there is no obvious forum for managing any conflicting commercial interests, nor for developing an integrated marketing and public communications plan.
2. The ability to place bus operational and marketing skills in a central position as the project develops is much more limited.
3. TEL will still require to be put into position for post-commencement operational management. If it has only limited involvement in the integration planning and tram delivery, it will be considerably less prepared for its operational management role in 2010.

4. A more peripheral role for TEL would not make use of the non-executive skills and experience which has been recently brought aboard and which may be usefully augmented further under a Scenario 1 model.
5. Except for the integration planning, this would probably not be a no-hoper for CEC and the Executive ; however, the integration planning is so key that a better model would almost certainly be favoured.

In summary, this could be made to work but does not seem to be as attractive as Scenario 1. For some parties, it will be very unattractive, leading to sub-optimal contribution.

<u>Scenario 3</u>

In some respects the opposite to Scenario 2. The essence is :

- Immediately following Royal Assent, the project delivery team within tie is transferred to TEL and all contractual relationships are legally re-assigned to TEL ; tie therefore ceases to have any material role in the tram project.
- TEL is therefore directly responsible for tram delivery and also picks up the service integration role described under Scenario 1. TEL would also take up the roles with communications and third-party operators
- At Financial Close, TEL is the contracting party for the Systems Contracts but also the deliverer, so there is no further role for tie. TEL would see through all the delivery aspects described under Scenario 1 and would also take on post-commencement responsibilities.

The benefits are :

- The tram project structure would be simplified by removing a company - tie.
- There would be no need for both tie and TEL to present to prospective tenderers and the structure presented to tenderers will be simpler.
- The tax planning around LB share transfer should be simplified as TEL would have a trading role (tram development) much earlier. The definitions would need further examination to be certain.

The flaws with this scenario include :

- None of tie's contracts except the DPOFA can be re-assigned without the other party's consent ; the process of legal re-assignment would therefore be very disruptive
- Tie is a project delivery company with its own internal efficiencies (shared services, cross-project skills) and management structure. These attributes would either be lost or would need to be replicated within TEL.

- There would be consequential disruption to tie's other projects ; overall the disruption will be a cause for SE concern. At a minimum, execution of this model will delay the tram programme.
- In some respects, places TEL in a position of conflict in that it is fully responsible for the tram delivery but has no direct control over LB (unless the share transfer can be executed early without tax risk). TEL would not have the same over-arching role as under Scenario 1, removing a valuable level of oversight from the structure.
- The nature of TEL would change from "intelligent client" to an operating project management company. This is not what was intended as TEL has been developed and has implications for Board composition, management structure, operating costs, insurance
- As a company with a range of projects, tie is in a position to sustain employment as project demands change and ultimately cease ; this enables tie to attract and retain high quality project-related people, whereas TEL would be a one-project business (in the sense of tram construction) and would not have this attribute.

OUTLINE BUSINESS PLAN FOR TEL

BACKGROUND

This document summarises the process required to prepare a business plan for TEL. The migration plan implicit in this proposal is that set out in the paper for the TEL Board on 22 November 2005. This has yet to be fully debated and approved and therefore the business plan process is also subject to change. The paper does not address other aspects of TEL's role such as communications and the proposed dialogue with third party operators, which require further debate.

The proposal envisages three planning periods, for which discrete but linked plans are required :

<u>TEL 2006 Plan</u> :

This should be prepared for approval by CEC prior to the end of the 2005-06 financial year. This plan covers the period to financial close which incorporates the FY 2006-07.

The Plan should set out the <u>workstreams</u> required to support the service integration role envisaged for TEL. In particular, the workstreams will be those which produce a basis on which to make transparent network scope and funding decisions in the latter part of 2006. The output will form the Integrated System Financial Projections ("the Projections") which will be a critical part of the Final Business Case for the tram project which is formalised in mid-2007 at financial close. These Projections will incorporate the construction period and the 30 year period of operation.

The plan will also reflect the day to day TEL operating costs of these activities in 2006-07, the funding sources and other matters relating to TEL's evolution such as resources, office accommodation etc

<u>TEL 2007 Plan :</u>

To be prepared c one year from now. This will reflect the fact that the scope decisions and work on all aspects of the Projections is substantially complete. The plan will incorporate the Projections as well as updating the 2006 Plan information for the period to financial close. The Projections will reflect the project budget for the construction period, subject to any changes required from the finalisation of the contracts in the period up to financial close. This Plan will therefore reflect TEL's role as primary contracting party from financial close and will also set out the final agreed governance structure for the construction period.

The Plan will also include the operating costs of these activities, the funding sources and other matters relating to TEL's evolution such as resources, office accommodation etc.

This Plan should survive through to 2009/2010, when a third stage plan will be required for the ensuing operational period.

The separation of the overall plan into 2006 and 2007 versions reflects CEC's requirement for annual plans, but also reflects the critical decision-making period around one year from now. The 2006 plan essentially prepares the ground for decisions on scope and the preparation of the Projections ; the 2007 Plan incorporates those decisions and establishes the plan for the construction period.

DELIVERABLES

TEL 2006 Plan

- Detailed workstream plan supporting assessment of different scope & funding options ; assessment of all aspects (operational and financial) of an integrated service plan including patronage and revenue modelling through the JRC process ; and Financial Projections capturing the cash flows.
- Preparation of Financial Projections
- Project management plan to deliver Projections
- Resource analysis for TEL operations
- Detailed governance, legal and corporate / tax structure for all periods of project

TEL 2007 Plan

- Fully optimised network scope and integration plan*
- Analysis of alternatives*
- Financial Projections reflecting optimum network, supporting assumptions and sensitivity analysis*
- Resource analysis for TEL operations
- Governance and contractual arrangements re-confirmed

*Essentially the output from the workstreams defined in the 2006 Plan.

RELATIONSHIP WITH OVERALL TRAM PROJECT PROGRAMME

Q4 2005

- JRC patronage / revenue modelling commenced
- Agreement on definition of configuration and integration options to be modelled
- SDG commence data capture and model construction
- Aggregate funding established in outline
- Governance and corporate structure and migration plan developed, including contractual structure to support tender process ; corporate tax planning developed
- Prepare draft TEL 2006 Plan

Q1 2006

- TEL governance and corporate structure and migration plan finalised, including contractual structure, tax planning
- High level review of principal Plan variables and assessment of Ocean Terminal / Airport financial characteristics
- Finalise TEL 2006 Plan
- Funding proposals developed, including financial risk-sharing
- OBC submitted and evaluated

Q2 2006

- Systems and vehicles tender commencement
- Financial model supporting Integrated System Financial Projections compiled

Q3 2006

- Tenders received and evaluated
- JRC modelling output received and evaluated
- Projections prepared covering all aspects of capital, revenue, lifecycle and operating costs and sensitivity testing
- Funding proposals re-assessed, including financial risk-sharing
- Scope evaluation

Q4 2006

- Draft FBC prepared, scope and funding decisions determined
- CEC / SE approval in principle
- Prepare draft TEL 2007 Plan

Q1 2007

- Tender negotiation and legal process
- TEL 2007 Plan finalised in line with draft FBC

Q2 2007

- Financial Close and construction commencement

<u>TEL 2006 Business Plan index</u>

1. Executive Summary
2. Background to TEL (brief but enough to let an un-involved reader understand its rationale)
3. Key Issues (Challenges TEL faces)
4. Statement of TEL Accountabilities - based on governance structure and relationships with CEC, tie, LB, Transdev and SE including current and prospective contractual arrangements
5. Governance and corporate structure and migration plan, including contractual structure to support tender process ; corporate tax planning
6. Definition of workstreams for :
    a. Scope option determination
    b. JRC patronage & revenue modeling - tram & bus ; "Superbus" / Streetcar
    c. Fares strategies
    d. Ticketing
    e. Integration with third party operators
    f. Strategic marketing in support of the integrated system, especially in relation to car use and assessment of brand positioning / development.
    g. Physical infrastructure - interchanges, Park and Rides, tram & bus stops, ticketing equipment ; all including capex and revenue generation potential
    h. Revenue protection strategy
    i. Back-office integration
    j. Depot co-location
    k. Asset realisation
    l. Operating costs of bus and tram operations and synergy assessment
    m. HR planning
    n. Advertising revenue planning
    o. Developer contributions and other property matters
    p. Capex planning (tram construction, bus acquisition)
    q. Lifecycle cost planning
    r. Overall project funding including financial risk-sharing
    s. Operational tax planning and cash flow modeling
    t. Safety management plans and strategy
    u. Quality systems development
    v. Purchasing strategy and opportunity analysis
    w. Risk planning and insurance

Compilation of Financial Projections and sensitivities reflecting all components as appropriate.

7. Economic & social impact [STAG / equivalent in line with FBC for SE purposes]
8. Communications and stakeholder management
9. Resource requirements with names / roles
10. Key Issues & Risks
11. Hygiene factors – e.g. Accommodation, advisors
12. Budget including detailed relationship to other budgets

Subsequent plans to adopt broadly the same headings but relevant to the stage of development. Need to consider also plan approval processes.

PROJECT MANAGEMENT

To be discussed – needs a clear structure and responsibilities, including the people involved, the information required from all parties, interfaces with other groups including the JRC working group, TEL Board and TPB, review and reporting disciplines etc

GB 29.11.05

TRAM PROJECT FUNDING
TRAM PROJECT BOARD MEETING 19.12.05

Purpose

There has been progress in recent weeks towards achieving some clarity on the tram project funding structure, but there are now critical decisions to be taken about the programme in relation to the main contracts. It is vital that the TPB on 19 December is able to conclude on the optimum process for the next steps otherwise substantial elements of the programme will be threatened. All parties are aware of the inflationary cost implications of delay and the attendant risks to execution from loss of key team members, loss of market credibility and resulting risk premia.

For planning purposes, we must assume both Bills receive Royal Assent by 31 March 2006 with minimal imposed additional cost, that financial close (award of Infraco) occurs as programmed at the end of June 2007 and that commencement of tram operations is 3 years later in mid 2010.

Decisions Required

The key principles which require decisions now are:

1. The decision at the last TPB was that there would be no release of the MUDFA tender until in –principle agreement between CEC and SE on funding has been reached. The target date for release of MUDFA tenders is early January 2006. This decision needs to be reconfirmed.

2. MUDFA, Vehicles and Infraco procurement will progress as programmed and for the scope of works and configuration options described in this paper. However no physical work will take place under the MUDFA contract until CEC/SE have a higher degree of confidence as to the economic and financial viability and affordability of the phase 1 network. This must be at the end of September 2006 <u>at the latest</u> to maintain programme for award of the Infraco and Vehicle contracts.

3. Confirm that the Outline Business Case (OBC) at end February 2006 will include details of the in-principle agreement between CEC and SE which sets out the aggregate funding for the project. This in principle funding agreement will also include the details of such project financing facilities as are deemed desirable to incentivise the Infraco contractor and manage cash flow commitments by CEC and SE. Clarity is also required regarding the sources of funding for the financing costs associated with such facilities.

4. Whether the Outline Business Case at end February 2006 should describe and provide justification for an assumed phase 1 network predicated by the in principle funding agreement at 2 above and an outline review of the economic and financial viability of that network by **tie** and TEL in the context of integrated tram and bus services. **However the Outline Business case will <u>not</u> be definitive in setting the phase 1 scope.**

5. The objective of delivering a Final Business Case **<u>in draft</u>** at the end of September 2006 reflecting the outcome of preliminary appraisal of Infraco and Vehicle tender prices, the output from JRC modelling and the parallel TEL Business Planning process.

6. Commitment to a stage-gate funding approach where all funding will be approved prior to the end of March, following a satisfactory OBC, for all activities in the period April to September 2006, specifically excluding physical utilities work and land acquisition costs. The total funding required for April to September 2006 will amount to **£17m** but this represents a stagegate in the total funding requirement for April 2006 to June 2007 of some **£158m**.

MUDFA, Vehicles and Infraco Procurement Timetable

The issue of tenders for the MUDFA utility contract will take place in early 2006. This will facilitate award of the MUDFA contract in April 2006 following Royal Assent and OBC. In the initial months MUDFA will focus on the planning and other activities required to support the construction timetable.

Tender documentation for the Vehicles and Infraco contracts will be prepared in the period to March 2006. Tenders will be issued in April 2006 following Royal Assent and will be returned in July for Vehicles and August for the Infrastructure contract. This timing facilitates issue of tender documents in early April to fit the overall programme, including Financial Close at the end of June 2007.

For MUDFA, Vehicles and Infraco, the above activities in the three months to March 2006 require clarity on aggregate funding to within a reasonable tolerance so that scope options are minimised. The basis on which funding will be provided must also be clear – the extent to which the bidders are being asked to provide independent funding will have a major bearing on the structure of the contracts, cost and programme. The recommended approach is set out under Project Financing below.

The construction timetable must also be clear or bidders will price in slippage risk in an undesirable manner. In particular the terms of the utility diversion contractual arrangements and the utility programme must be clear to support the construction tender.

Outline Business Case at end February 2006

tie has previously committed to producing an OBC in Spring 2006 to support the decision to go to tender for the Vehicles and Infraco. It was understood that this would represent an update on the documentation provided during the second half of 2005 which detailed the procurement strategy, risk management processes and an up to date view of the capital costs (which are unlikely to have changed materially).

There has recently been some focus on a high-level view of the operating viability of the Airport to Ocean Terminal route as a backstop or core network. This is being progressed by TEL with input from **tie** and will feature in much more detail when the full operating projections emerge in the TEL Business Plan later in the year, including output from the JRC modelling. The Final Business Case for tram will essentially be a sub-set of the TEL Business Plan which will support Financial Close.

It is important to recognise that any work done now on the Airport to Ocean Terminal will not benefit from the rigour being applied through the JRC modelling and TEL Business Planning process. It is necessary to recognise this now, so that no false expectations are built about the “new” information that may feature in the OBC. In addition, it is important to note that the two tram lines have previously been subjected to detailed financial and economic assessment and the conclusion was that both passed the relevant tests.

The over-arching factor which will be assessed in the TEL Business Plan is the operational viability of an integrated network of tram and bus, a complex and sensitive exercise which is fundamental to the view that CEC takes as the party ultimately responsible for the operational viability of the integrated network. That exercise cannot be completed to inform the OBC.

Phase 1 network assumptions

tie has been working toward an “Airport Network” model, including all of Line 1 plus Line 2 to the Airport. The total inflated capital cost is estimated at £575m including contingency allowance (£648m including incremental optimism bias). This assumes the 2010 programme is not delayed. It is currently estimated that the £375m grant would index to £490m and that CEC will provide £45m in cash and land contribution. This leaves a gap of £40m compared to the cost estimate including contingency or 7% of the total.

tie believes this gap is sufficiently small to justify proceeding with the work designed to deliver the Airport Network pending re-evaluation when tender responses are received.

tie is working with the assumption that it will now proceed with the construction of documents for tender of the network for the following 3 configurations:

	Cost including contingency	Cost Including Optimism Bias
1. Airport to Ocean Terminal – the core affordable network to be appraised as part of the OBC.	£429m	£484m
2. Airport to Ocean Terminal **plus** Haymarket to Granton Square	£505m	£569m
3. Airport to Ocean Terminal **plus** Haymarket to Granton Square **plus** Granton Square to Ocean Terminal	£575m	£648m
For reference – the cost of the full network of Lines 1 and 2	*£634m*	*£714m*

The tenders will be constructed to ensure the capital cost information for all three options is available and the TEL Business Plan / Final Business Case will examine the economic and financial viability operational viability of all three options.

Stage-gate funding to progress the project

The strategy which follows is predicated on the following objectives :

1. Minimise programme risk and consequential cost risk
2. Present a coherent approach to the market which gives the best possibility of achieving value for money
3. Minimise aborted cost risk

The strategy proposed to balance these outcomes is:

- Accelerating the JRC modelling to the maximum extent possible - the earliest we believe it can be credibly and reliably delivered is June / July. The contractor is being consulted with a view to obtaining outputs to support the delivery of a draft TEL Business Plan / tram Final Business case at the end of September 2006.

- Ensuring that all aspects of the TEL business planning are executed in advance of JRC output, so that the final compilation and assessment can be handled as soon as the JRC output is available.

- Ensuring that the Vehicles and Infrastructure tenders are released in early April 2006 and are returned by end-July 2006 and end August respectively.

- Restricting utility work to planning, preparation and purchase of long lead items, but no physical work prior to end-September 2006.

- Preparing for land & property acquisition but making no actual acquisitions until after 30 September 2006.

- All design and procurement work proceeds as planned such that the overall programme is unchanged

The unconstrained funding requirements presented in the draft **tie** Business Plan are **£157m** for the 15 months from April 2006 to June 2007. This sum needs to be approved subject to confirmation to proceed immediately following delivery of a draft Final Business Case in September 2006. At that stage-gate review point, when the scope and funding decisions can be reconfirmed with a high degree of confidence and if positive, actual utility work can commence, land & property can be acquired and the process toward financial close (Vehicle provider selection and CARP/BAFO bidders for Infraco selection) can proceed.

This strategy would require funding of **£9m** for the quarter to June 2006 and further funding of **£8m** through to the end-September 2006 stage-gate when a further commitment will be required. Total funding that would require approval from CEC/SE upon receipt of the OBC and prior to 31 March 2006 is therefore **£17m** to end September 2006.

The detailed numbers require further work but should not change materially.

This strategy does not impede programme unnecessarily (more than 3 months) and therefore mitigates incremental costs from delay. It also minimises abortive cost risk. However, the existence of a stage-gate at end-September will require careful handling in the tender process with MUDFA, Vehicles and Infraco bidders. There may be a requirement to underwrite bid costs and (in the case of MUDFA) some run-off costs. However, the principal of a clear-cut decision point should not be too alarming. If this strategy is adopted, MUDFA proceeds as presently planned and the Vehicles and Infraco tenders also proceed as planned.

Project Financing

tie requires a definitive position from CEC/SE on the need for Infraco and Vehicle bidders to incorporate external finance into their bids. This has the capacity to create substantial delay, which can be mitigated only by an early evaluation of the requirements and a detailed legal and financial evaluation of the implications for the tender process.

As part of the continuing process of developing our procurement strategy, **tie** is focussing on a payment mechanism under the Infraco contract which will require a proportion of the total costs to financed privately under Infraco and to be repaid by system availability linked payments from the public sector in the first six years of operation of the tram network. The profile of such payments might be 10% in years 1 and 2, 15% in years 3 and 4 and 25% in years 5 and 6. The construction of such a financing and availability payment regime will ensure private sector capital is put at risk in a manner similar to that achieved under a full PFI arrangement.

The unanswered question is how much of the total costs should be financed in this manner. **tie** considers that a if a meaningful proportion of the total costs are financed in this manner it will deliver the desirable risk transfer to the private sector. However there may be underlying reasons why CEC/SE might want the extent of such facilities to be higher. If extensive facilities are envisages then the funding of the underlying financing costs becomes a significant issue in assessing affordability and there must be clarity at the outset as to how these costs might be financed. **tie** can provide the necessary financial modelling to facilitate this decision making process.

In advance of further detailed analysis being available, **tie** would recommend that financing amounting to £100m should be sought from the private sector.