

Default Risk Allocation in Third Party Agreements

Introduction

It may be unclear to an investor or developer (particularly if new to the railway), how the risks differ between building on the operational railway compared with building on high street, highway or off network environments.

The allocation of risk in Network Rail's third party suite of agreements was originally established in accordance with the Office of Rail Regulation '*Policy Framework for Investments: Conclusions*' published October 2005, this was reviewed and consolidated into the Office of Rail Regulation 'Investment Framework Consolidated Policy and Guidelines' and published in October 2010. The framework identifies risk allocation for schemes promoted by 3rd parties and is a "fair balance of risk between Network Rail and investors".

Whilst there is guidance to using the Third-Party template agreements this does not detail the specific risks taken by the Third Party and Network Rail. Network Rail would like to make it easier for Third Parties to use the template agreements, so has provided the Default Risk Allocation Table below to help Third Parties understand where the risks lie and who takes responsibility for them. The risk allocation is designed so that the consequences of any project risk would be felt by the party best able to mitigate or control the risk. This table specifies the key risks and whether they fall directly to the customer (the Third Party promoting and/or delivering the works) or to Network Rail. The high-level principles of risk allocation in Third Party Agreements are;

1. The Customer funds the direct incremental costs of the scheme, including non-Industry Risk;
2. Where an Asset Protection Agreement is used, the Customer should transfer design construction risks to its contractors, or should manage those risks itself where it cannot transfer them;
3. Where Network Rail is delivering under a Development Services Agreement or an Implementation Agreement, it will assume any risks inherent in the contracts with their Contractors;
4. The Customer's liability to Network Rail for non-Industry Risk should be capped at an appropriate level (although liability for payment obligations, death and personal injury, negligence (except design) and fraud is uncapped);
5. Network Rail's liability for contractual breach and negligence is capped at the level of the value of the Works and or Services being provided (although liability for death, personal injury and fraud is uncapped);
6. Network Rail should not be required to take risk resulting in substantial extra costs unless funded through the Risk Funds (see Guide to Template Agreements for Undertaking Railway Projects);
7. Network Rail should be entitled to charge:
 - Costs reasonably and properly incurred by Network Rail (or a fixed amount if an Implementation Agreement (Fixed Price) is used) subject to any agreed assumptions or exclusions;
 - Network Rail Fee to contribute towards funding contractual liabilities;

- Industry Risk Fee to contribute towards funding generic rail industry risks (together the “Risk Funds”); and
 - Additional Expense incurred in connection with incremental maintenance costs, etc. arising from the project.
8. Liquidated Damages - Network Rail will seek to agree an acceptable programme with the Customer. Network Rail will put in place personnel and processes to manage to this programme. However, slippage may still occur, with potential knock - on costs to the Customer. Network Rail will pay liquidated damages which are calculated on a pre-estimate of the Customer's loss which will be negotiated by the parties acting reasonably. Liquidated Damages will be payable from a date (to be agreed by the parties) which recognises the date when the Customer would start incurring financial losses. This may not be the same as the completion date – for example if it is a phased project or assets are taken into use prior to “completion”. Where it is not possible to agree a genuine pre-estimate of the Customer's losses then provision may need to be included which caps any Customer losses payable in respect of delay (please consult Corporate Commercial for support in agreeing this cap). If a Customer cannot demonstrate a pre-estimate of losses, no Liquidated Damages will be included in the agreement
9. Network Operation Issue - A network operation issue may be an operational emergency or safety critical event. However, it can include directions of competent authorities such as the ORR, cancelled possessions and changes in the Network Licence requirements which affect the Customer's project. The project may also be affected if engineering records required for the project are also required in order to deal with one of the Network Operation Issues already mentioned. The Customer will not be liable for costs arising from a Network Operation Issue.

This risk allocation assumes that the sponsoring customer will pay into the Risk Funds to cover the cost of low-probability, high-impact risks that neither party can either foresee, or control, and/or which Network Rail is not funded to support, thereby removing a barrier to investment.

The Risk Funds enable Network Rail to stand in front of certain industry risks and Network Rail risks which are incorporated into the agreement and help to fund those contractual liabilities it takes relating to such risks e.g. asset defects not picked up in survey work, safety critical events, operational emergencies, possessions cancelled by Network Rail, changes in industry specific laws and standards etc. There is more information on the Risk Funds in Guide to Template Agreements for Undertaking Railway Projects, that can be found in the Downloads for Third Parties section of the Network Rail website.

The following represents the default risk allocation reflected in the template agreements that support feasibility, design development, detailed design or implementation when either the third-party Customer or Network Rail is undertaking procurement of the services and or works.

Risk Allocation Matrix		Agreement Types				
		NR Implementing				Asset protection
		Basic Services [BSA] [DSA pre-feasibility only]	Outline Design [DSA]	Detailed Design [DSA]	Implementation (BIA/IA)	All stages (BAPA/APA)
Risk Category						
Specification	Scope	CUS	CUS	CUS	CUS	CUS
	Technical specification (including compliance with Standards, laws and regulations)	CUS	CUS	NR/CUS	NR/CUS	CUS
	Commercial specification	CUS	CUS	CUS	CUS	CUS
	Operational performance	CUS	CUS	NR/CUS	NR/CUS	CUS
Buisness Case, Concept & Feasibility		CUS	CUS	CUS	CUS	CUS
Outline Design/ approval in principle		CUS	NR	NR/CUS	NR/CUS	CUS
Asset Operational Performance		CUS	CUS	CUS	CUS	CUS
Operating Costs	After Taking Over before Final Certificate				CUS	CUS
	After Final Certificate				NR	NR
Project Programme Timescales	No Liquidated Damages	CUS	CUS	NR/CUS	NR/CUS	CUS
	Liquidated Damages			NR/CUS	NR/CUS	NR/CUS
Payment to Network Rail	bankruptcy/insolvency/default of Customer	NR/CUS	NR/CUS	NR/CUS	NR/CUS	NR/CUS
	other valid claims against Customer	NR/CUS	NR/CUS	NR/CUS	NR/CUS	NR/CUS
Possession	Booking accuracy/error by Network Rail		NR/CUS	NR/CUS	NR/CUS	NR
	Booking accuracy/error by Other		CUS	CUS	CUS	CUS
	Cancellation by Network Rail for Network Operational issue		NR	NR	NR	NR
	Cancellation by Network Rail for no good reason		NR	NR	NR	NR
	Cancellation by Network Rail due to train operator fault		CUS	NR/CUS	NR/CUS	CUS
	Other		CUS	NR/CUS	NR/CUS	CUS
Possessions Management	Possession Management Staff		NR	NR	NR	CUS
Safety Liability	site safety management		NR	NR	NR	CUS
	network operational safety (NR breach)		NR	NR	NR	NR
	network operational safety (Other party breach/action)		NR	NR	NR	NR
CDM Client	CDM Client	NR/CUS	NR/CUS	NR/CUS	NR	CUS
Environmental Contamination on NR land	Existing contamination project impact cost of clean up for active or dormant contamination	CUS	CUS	CUS	CUS	CUS
	mis-management of active (known)	NR	NR	NR	NR	CUS
	mis-management of dormant identification (unknown)		NR	NR	NR	CUS
	redesign due to dormant (unknown) identification		CUS	CUS	CUS	CUS
	New contamination (due to project)		CUS	CUS	NR/CUS	CUS
Environmental Contamination on Customer land	before or after transfer, existing or new from enhancement, active or dormant.	CUS	CUS	CUS	CUS	CUS
Environmental Contamination Unlicensed storage (disposal/project impact)	Management of existing unlicensed storage on NR Land	NR	NR	NR	NR	NR
	Management of new unlicensed storage from project on NR land			NR	NR	CUS
	on Customer land, existing or new	CUS	CUS	NR/CUS	NR/CUS	CUS
	on Other land, existing or new	CUS	CUS	CUS	CUS	CUS
Ground Conditions	mining subsidence, geological condition		CUS	NR/CUS	NR/CUS	CUS
New land requirements/purchase	cost of purchase			CUS	CUS	CUS
	Suitability - area, location, constraints etc		NR	NR	NR	CUS
Public Liability issues	damage to NR property by a contractor		NR	NR	NR	CUS
	damage to non-NR property by a contractor		NR	NR	NR	CUS
Construction All Risk cover				NR	NR	CUS
Professional indemnity issue - costs/losses arising from error, omission or negligence to:	NR by a contractor		NR	NR	NR	CUS
	NR by NR	NR	NR	NR	NR	NR
	Customer by NR/Contractor	NR	NR	NR	NR	NR
	Contractor/NR by Customer	CUS	CUS	CUS	CUS	CUS
	other by Customer	CUS	CUS	CUS	CUS	CUS
Latent defect in completed works within warranty	other by NR	NR	NR	NR	NR	NR
	Prior to acceptance				NR	CUS
Latent defect in completed works outides warranty	After acceptance				NR	CUS
	Prior to acceptance				NR	CUS
Asset defect (wheter or not known at commencement date)	After acceptance				NR	NR
	Renewal required for normal operations				NR	NR
Force Majeure	Renewal required for enhancement only				CUS	CUS
		NR/CUS	NR/CUS	NR/CUS	NR/CUS	CUS/TRF
Funding	provision of	CUS	CUS	CUS	CUS	CUS
	cost of	CUS	CUS	CUS	CUS	CUS
	contribution by NR			NR	NR	NR
Taking into use				NR	NR	
Completion				NR	NR	
Consents, wayleaves, easements etc			CUS	CUS	CUS	CUS
Change of	Law (General)		CUS	CUS	CUS	CUS
	Law (specific to rail industry)		NR	NR	NR	NR
	Group Standards		NR	NR	NR	NR
	NR Standards (Safety)		NR	NR	NR	NR/CUS
	NR Standards (Other)		NR	NR	NR	CUS
Network Code	- Regulated change (Network/Station/Depot)		CUS	CUS	CUS	CUS
	- Possessions over-run (Schedule 8)			NR/CUS	NR/CUS	NR/CUS
Tax and VAT Liability		CUS	CUS	CUS	CUS	CUS
Industrial Action	Industrial action (customer)	CUS	CUS	CUS	CUS	CUS
	Industrial action (NR)	NR	NR	NR	NR	NR
	Industrial action (Other)	NR/CUS	NR/CUS	NR/CUS	NR/CUS	NR/CUS
Network Operation Issue			NR	NR	NR	NR
Provision of incorrect asset information		CUS	CUS	CUS	NR	CUS
Interfacing Projects	Interfacing Projects			NR	NR	NR/CUS
	Failure to identify	NR	NR	NR	NR	NR
	Impact of interfacing projects			NR	NR	NR/CUS
Land claims post taking into use						
	Within CAP				CUS	CUS
Noise Claims	Above CAP				NR	NR
	before taking into use within CAP				CUS	CUS
	before taking into use above CAP				NR	NR
	Post taking into use within CAP				CUS	CUS
	Post taking into use above CAP				NR	NR