

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. 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 |
| | Above CAP | | | | NR | NR |
| Noise Claims | 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 |