



DEVELOPMENT AROUND RAILWAY INFRASTRUCTURE – MIND THE GAP!

Given the scarcity of land available for large scale urban development in the UK's densely packed city centres, developers are increasingly building new schemes adjacent to or above operational railway assets. The multitude of buildings being erected around King's Cross station, the construction of various over-station developments above Crossrail stations and the redevelopment of the iconic Battersea Power Station to include buildings above the new Northern Line tube station are just a few recent examples of such developments in central London. However such projects have a unique set of challenges and pitfalls for the uninitiated.

From the developer's perspective, a successful negotiation of the relevant asset protection arrangement at an early stage of the process is key to the smooth running of the development. To mitigate as much development risk as possible a well-advised developer will seek to pass down many of its obligations in the asset protection arrangement to its construction team whilst recognising that there are some inherent limitations to this risk sharing.

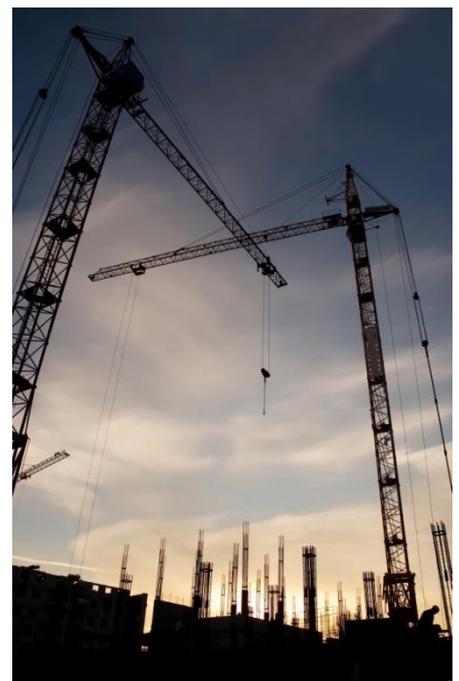
WHY ARE ASSET PROTECTION ARRANGEMENTS IMPORTANT?

To maintain the integrity and safety of the railway, owners of railway infrastructure such as Network Rail, Transport for London and Crossrail (referred to generically in this briefing as the Railway Company) will require developers intending to work within a prescribed "zone of influence" close to railway infrastructure to enter into a contractual arrangement with the Railway Company containing detailed asset protection provisions. This contract may take the form of a Basic Asset Protection Agreement (BAPA) or, for larger schemes that will have a greater operational impact on the railway and that may involve temporary "possessions" of railway infrastructure, a more detailed Asset Protection Agreement (APA) will be required. In the case of the construction of over-station developments (OSDs), the asset protection arrangements are likely to be contained in a development agreement entered into between the developer and the Railway Company.

WHAT CAN GO WRONG?

There are additional risks associated with developments adjacent to or above railway infrastructure that need to be carefully considered by the developer

"The construction of OSDs and the redevelopment of railway stations to incorporate other uses demonstrate the increased willingness of railway infrastructure owners to unlock value from their real estate by enabling such developments to take place."



and mitigated wherever possible in the project documentation. If a tower crane collapses or there is a major fire at the construction site then, as well as damaging the developer's property, it can also cause injuries to users of the railway or station, damage the railway infrastructure, damage the property of train operators (e.g. rolling stock) and cause consequential financial losses to the Railway Company and train operators.

Even where there is no physical damage to the railway (e.g. where a potentially dangerous object is unearthed as part of a basement dig, which could be unexploded ordnance or something more mundane like an empty gas canister), an unscheduled track closure on the railway as a consequence of such an incident can result in Network Rail being obliged under the Network Code to refund large sums of money to train operating companies. Network Rail in turn will expect to recover these losses from the developer pursuant to the indemnities in the asset protection arrangement and the cost to the developer can easily run into millions of pounds per day.

HOW CAN THIS RISK BE MITIGATED?

Developers tend to assume that the risks they take on under the asset protection arrangements (including those outlined above) can be "backed down" to the construction team, but this is rarely the case. Most building contracts and professional appointments are based on industry standard forms and even where bespoke documents are used they will be subject to very well entrenched market practice in terms of risk allocation and indemnities. There will therefore inevitably be a gap in the developer's risk mitigation strategy.

There is no perfect cure to this mismatch, but experienced developers often look to minimise the gap between their obligations to the Railway Company in the asset protection arrangement and the obligations owed to them by the main contractor and the professional team in the building contract and professional appointments. Some of the main issues to be aware of, and the steps that can be taken to mitigate the risks, are as follows:

Bonding

The covenant strength of the developer and the provision of some form of security for performance of the developer's obligations under the asset protection arrangement will be of paramount importance to the Railway Company. Where the developer does not meet a prescribed net assets test and cannot provide a guarantee from an affiliated company with a significant covenant strength, the developer will typically be asked at its own cost to provide the Railway Company with an "on demand" bond from a bank in an agreed multi-million pound amount to provide comfort to the Railway Company that the developer will be able to meet its liabilities. Such bonds do not require proof of loss before they can be called and there will usually be a negotiation with the Railway Company to agree when the bond should expire.

To mitigate the effects of any call on the developer's bond in relation to defective design or construction most developers will ask (and pay for) their main contractor to provide them with a "performance bond". A performance bond is usually in an amount equal to 10% of the initial contract sum (the bond amount is rarely adjusted for variations) which expires shortly after practical completion (PC) of the development and is provided by a surety company rather than a bank. In contrast to the developer's bond, performance bonds require proof of breach and quantification of loss before the bondsman is required to pay out and litigation is often necessary, so it will not always be



Safety first!

- The Railway Company will insist on retaining sole discretion in relation to safety issues.
- Safeguarding the railway will be the Railway Company's primary concern and they will reserve the right in the asset protection agreement to take whatever action they consider necessary to protect the safety, structure and operation of the railway and the safety of persons or property on or near the railway (including a right to require the developer to suspend the carrying out of the works).
- Time can be wasted seeking to negotiate provisions that are considered "boilerplate" and sacrosanct to the Railway Company.

possible for the developer to recover amounts paid out to the Railway Company from the main contractor.

"Third party agreement" provisions

Most developers include a schedule of "third party agreements" in their construction documents which lists agreements between the developer and tenants, funders, local authorities and other interested third parties. The contractor or consultant is obliged to take account of the relevant terms when performing its obligations to the developer and must not put the developer in breach. The developer should ensure that the asset protection arrangement with the Railway Company is listed in the schedule of "third party agreements" with an accompanying indemnity from the relevant contractor or consultant, but experienced contractors and consultants will typically seek to negotiate the terms of such an indemnity or to limit or restrict their liability in the event of any claim.

Provision of collateral warranties

Even where the developer manages to secure "third party agreement" provisions in its construction documents in relation to the asset protection arrangement, there are nevertheless some specific provisions from the agreed documentation with the Railway Company that will need to be provided for expressly in the construction documents. For instance, the developer will usually be obliged to procure collateral warranties in favour of the Railway Company from each member of the construction and professional team. In most cases, there will be no flexibility regarding the form of collateral warranty, which the Railway Company will expect to be in a prescribed form. Most contractors and consultants (in conjunction with their professional indemnity insurers) will expect to negotiate the terms of the collateral warranty, for example in relation to the assignment provisions, but this will not generally be accepted by the Railway Company. To prevent this from happening, developers may wish to include the form of collateral warranty to be provided to the Railway Company in a separate, non-negotiable schedule to the relevant contract or appointment.

The whole process will be easier for the developer to manage if it only engages contractors and consultants who are on the Railway Company's "approved list" and who are familiar with the needs and expectations of the Railway Company, including in relation to collateral warranties. Depending on the nature of the works and the requirements of the Railway Company, the contractor may even be required to hold a particular form of licence from the Railway Company. This requirement should be factored into all discussions regarding selection of the construction team at an early stage in order to avoid delays. It is also wise to check with potential contractors whether their licence is up-to-date and has not yet expired since the renewal process can take some time.

Duration of liability for defects

Most construction documents contain an express provision which prevents the developer from suing the contractor and professional team for defects once the period of 12 years has passed since PC of the relevant works. However many asset protection arrangements do not contain an equivalent limitation on the developer's liability, which often instead runs for a period of 12 years from the indemnified loss being established – which could be many years after the contractual limitation period under the construction documents has expired. Some developers take a commercial view on this on the basis that most latent defects appear within the first few years after PC but there is nevertheless a

Other considerations

- A developer should always consider its exit strategy when signing up to an asset protection arrangement, which will typically contain restrictions on assignment and change of control provisions.
- Careful thought will also be needed in relation to multi-phase projects or developments which comprise several separate buildings – should there be a master asset protection arrangement or one for each phase (with or without cross-default provisions)? Will the developer have a right to sever separate buildings and novate the rights and obligations under the asset protection arrangement to another owner or developer? Will the developer be able to sell a property that has been developed when the rest of the project is ongoing without the purchaser becoming liable under the asset protection arrangement for the ongoing works?
- It may be important for a developer to preserve its ability to finance the development – e.g. by ensuring that it has an opportunity under the asset protection arrangement to remedy certain breaches and by incorporating lender step-in rights.

mismatch in risk allocation that needs to be considered.

Timing for completion of development

Depending on the nature of the works, the asset protection arrangement may impose an obligation on the developer to commence the works by a certain date or an obligation to complete the works by a defined longstop date (which may be extendable by force majeure events). A full build out obligation is most likely to be imposed by the Railway Company when the Railway Company has an economic interest in the completed development, e.g. a rent share in a lease of an OSD. Developers should carefully consider how they can seek to protect themselves in cases of delay (e.g. by including appropriate buffer periods as against the dates in the building contracts), which in many cases may be largely or wholly outside of their control.

Design approvals

The Railway Company will usually require extensive rights to approve and/or make changes to the developer's proposed designs and these controls will typically extend beyond mere structural issues – for example, the Railway Company will want to ensure that developments adjacent to or above railway tracks do not include any lighting features that could be mistaken for railway signals and that the glazing and cladding do not possess reflective qualities that could dazzle passing train drivers. Early and continued engagement with the Railway Company in relation to design development will therefore be essential to preventing delays to the programme. Since the developer will not have any recourse against the Railway Company in the event that any of the changes imposed by the Railway Company turn out to be defective, the developer can mitigate its potential exposure here by including appropriate provisions in the professional appointments and building contracts to seek to preserve the liability of the designer even where there have been such required changes.

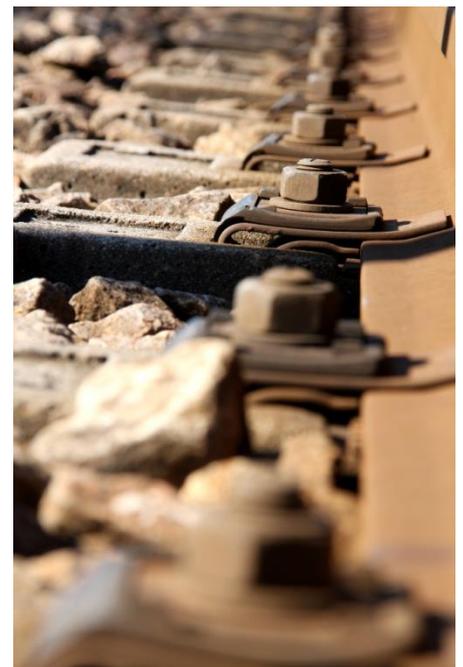
So called "non-damage" insurance

It is always worth considering project insurance issues at the outset as the developer may be able to protect itself from potential exposures to third parties (including the Railway Company and train operators) by placing appropriate insurance. "Non-damage" insurance is intended to protect against loss suffered by the developer where there turns out to be no actual physical damage to the railway infrastructure. In these circumstances most conventional insurance policies will not respond but this "non-damage" cover is intended to cover pure financial losses, such as the amounts paid out by the developer to the Railway Company under the indemnities in the relevant asset protection arrangement in respect of Network Code payments to train operators.

AVOID PROJECT DERAILMENT...

Developers are, in some cases, discovering the hard way that early engagement with the Railway Company is key to avoiding their project being derailed by delays in obtaining the necessary approvals or authorisations. Forging a good relationship with the Railway Company's personnel and understanding that their primary concern is safety is a critical part of delivering such projects on time and on budget. Equally important from the developer's perspective to prevent difficulties or disputes down the line and to minimise unnecessary risk exposure is ensuring that the construction documents are, to the greatest extent possible, properly interfaced from the outset with the asset protection arrangements agreed with the Railway Company.

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