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15 January 2018

Company Secretary  
Network Rail Infrastructure Limited  
1 Eversholt Street  
London  
NW1 2DN

## **Network licence condition 4 (Financial ring-fence): Euston Station Development Agreement**

### **Decision**

1. On 9 October 2017, Network Rail applied for consent, under condition 4.1(c) of its network licence, proposing to enter into a development agreement with other parties to allow the development of parts of the Euston estate for commercial and residential purposes. The details of the proposal are attached at Annex A.
2. Network Rail proposed to work with the Department for Transport (DfT) to progress the development, stating that the development agreement would be between Network Rail, The Secretary of State for Transport, a prospective development partner and any guarantor, as necessary.
3. We have considered the information supplied by Network Rail and under condition 4.1(c) of its network licence, the Office of Rail and Road (ORR) consents to the proposals as proposed by Network Rail in its letter of 9 October 2017.

### **Reasons for decision**

4. The purpose of the financial ring-fence licence condition is to restrict Network Rail's ability to divert its resources, or to allow them to be diverted to activities that are not Permitted Business<sup>1</sup>. Network Rail must gain our consent if it wishes to resource any activity that is not Permitted Business, unless the level of resource is sufficiently low that it can be considered a *de minimis* activity, as defined in condition 4.7 - 4.9.
5. In considering the request, we have, in accordance with our usual procedures for processing financial ring-fence consent requests, borne in mind three overarching factors. These are:
  - (a) whether the proposal would be likely to affect the operation of the railway;
  - (b) whether there are any state aid or competition issues arising; and
  - (c) any financial risks arising from the proposal.



<sup>1</sup> As defined in Part 2 of Network Rail's network licence.

6. With respect to paragraph 5(a), we note the statements made by Network Rail in its submission of 9 October 2017 and the subsequent statement it sent to us on 31 October 2017, that the activities it proposes to carry out will not cause any significant management distraction nor have an adverse impact on Network Rail's ability to undertake its Permitted Business. We also note that Network Rail's submission recognises that in order for the scheme to progress it will need our consent to any land disposal under Condition 7 of its network licence. Our approval of Network Rail's proposals under Condition 4 of the network licence does not imply a pre-approval of a proposal submitted to us under Condition 7.

7. We have no concerns to pursue under paragraph 5(b). Although monitoring state aid compliance is not ORR's role, we note that DfT is aware of Network Rail's scheme and is engaged on the initiative. We have no concerns that Network Rail's proposal of 9 October 2017 raises competition issues, in that we do not consider, in itself, it would have any material adverse effect on competition or otherwise constitute anti-competitive conduct. We note that we have already given our consent to Network Rail, under Condition 4 of its network licence, to engage in this type of property activity, within limits, until 31 March 2019<sup>2</sup>.

8. We have considered, under paragraph 5(c), whether entering into the development agreement would bring risk to Network Rail's financial position. We note Network Rail's statement that DfT has engaged with the proposals and, in accordance with a key term of the development agreement, DfT will make any necessary cash contribution, up to £20m, so that Network Rail itself is not required to make any cash payment. DfT confirmed this to us in its letters dated 27 November 2017 and 13 December 2017 (at Annex B). Therefore, we consider that the proposal does not place any undue financial risk on Network Rail within this control period, which ends 31 March 2019.

9. In reaching our decision we have given particular weight to our duty to exercise our functions in a manner which we consider best calculated to "*protect the interests of users of railway services*".

10. This consent is valid from this day until 31 March 2019 or such longer period as ORR may specify in a notice given in writing to Network Rail.

11. ORR may modify or revoke this consent at any time in a notice given in writing to Network Rail if it appears to ORR requisite or expedient to do so having regard to the duties imposed on ORR by section 4 of the Railways Act.

**Carl Hetherington**

**Duly authorised by the Office of Rail and Road**

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<sup>2</sup> See [http://orr.gov.uk/data/assets/pdf\\_file/0020/19424/new-form-of-consent-to-property-related-activities-2015-09-29.pdf](http://orr.gov.uk/data/assets/pdf_file/0020/19424/new-form-of-consent-to-property-related-activities-2015-09-29.pdf)

## Annex A

Les Waters  
Licensing Manager  
Office of Rail and Road  
One Kemble Street  
London  
WC2B 4AN

Network Rail  
The Quadrant:MK  
Elder Gate  
Milton Keynes  
MK9 1EN

9 October 2017

Dear Les

### **Euston Station Development Agreement**

#### **Background**

By way of background, the High Speed 2 (HS2) station at Euston is to be constructed on land at and also abutting the existing Euston station.

Under the HS2 Act 2017, the Department for Transport (DfT) has Compulsory Purchase Order (CPO) powers to acquire, amongst other things, part of the existing Euston station and track in the throat of the existing station for development in connection with the new HS2 station.

In 2014, Network Rail Infrastructure Limited (Network Rail) entered into a Protective Provisions Agreement controlling the extent and method under which these powers could be exercised against Network Rail so as to protect the operation and safety of the railway.

#### **Proposal**

Network Rail proposes collaborating with DfT to enable the development of parts of the combined Euston estate for commercial and residential purposes. It is proposed that Network Rail enter into a development agreement with The Secretary of State for Transport (as acquiring authority in respect of the high speed station at Euston), a prospective development partner and any guarantor (as necessary) in January/February 2018.

The key terms of the development agreement are:

- The appointment of a master development partner (MDP)
- Joint obligations on DfT and Network Rail to contribute towards the costs of obtaining outline planning permissions (capped at £20 million) which is to be underwritten by DfT

- The MDP to seek outline followed by full planning permission for development of the Euston estate being airspace over the new high speed station and the redeveloped Euston station and adjacent land.
- Arrangements which control phasing of the development and draw down of phases (a description of each phase is listed below).

<b>Phase</b>	<b>Description</b>
A	The new high speed station
B1	The two platforms on the western side of the existing Euston station which may be acquired by HS2
B2	The existing/redeveloped Euston Station. If the property in phase B1 is not acquired by HS2 then phase B2 will include B1.
Gardens	Euston Square Gardens

- Obligations to grant investment long leases to the MDP on completion of building works for each development phase.
- The establishment of a Euston Development Board (EDB).

Entry into the development agreement will enable the MDP to draw down land subject to the conditions contained in the development agreement. For Network Rail land, the conditions relate primarily to funding and compliance with various protections relating to the operation and safety of Network Rail's network. Draw down of land will be conditional upon Network Rail securing internal clearance and consent under condition 7 of the Network Licence.

The development agreement will contain an entitlement for Network Rail to take a share in net development profits with DfT. It is intended that any funds to be paid to Network Rail would be ring fenced against future development costs of Euston station, although it is unlikely that there would be any distribution within the next five to ten years.

The EDB will comprise of Network Rail, DfT and HS2 although only Network Rail and DfT (as landowners) will have voting rights. The Developer will be invited to meetings but the EDB will be entitled to exclude it from meetings (or parts of meetings) where commercially sensitive matters are being discussed or are on the agenda. The functions of the EDB (to be reviewed as appropriate) will include to:

- Discuss and develop items that are submitted to the landowners for approval
- Provide advice and recommendations on design, planning and commercial proposals for development
- Integrate the delivery of the HS2 station and the redevelopment of Network Rail's Euston station (as and when such redevelopment is funded and authorised), Crossrail 2 proposals and any other related development opportunities

- Consider strategy, strategic issues, risks and proposals for mitigating disruption
- Support co-ordination between stakeholder activities and engage effectively with stakeholders
- Monitor progress of community engagement.

The development of the HS2 station and the redevelopment of Euston station are outside the scope of the development agreement. In respect of GRIP stages 1-8 (initial design to completion of works) in relation to the redevelopment of existing Euston station, all work will be subject to DfT funding.

### **Protections for Network Rail**

In addition to the development agreement, Network Rail and DfT propose to enter into a collaboration agreement which will address major commercial points such as governance, value sharing, land pooling, costs and liabilities. These issues are outlined in more detail below:

**Governance** – the collaboration agreement will cover the decisions that Network Rail and DfT (as landowners) will be required to make pursuant to the development agreement and will include governance mechanisms through which the activities of the MDP will be controlled over the life of the development agreement.

**Land pooling** - irrespective of the value of specific development plots across the site, there will be no distinction as to where value is created across the combined landholdings. The collaboration agreement will control how Network Rail and DfT will act to deliver the opportunity area presented to the MDP and procure that, where a plot straddles multiple freehold interests, the parties will rationalise their separate freehold interests into a simplified long leasehold that will enable the MDP to transact with a single landholder. Tax implications have been considered and will be revisited ahead of any decision on appropriate title transfer mechanisms at drawdown.

**Value sharing** – value will be generated through the sale of development plots to the MDP. Receipts will be secured through one of the following transaction types:

1. **Land Sale** - market value at drawdown (or the guaranteed minimum land value if higher) is paid to Network Rail and DfT (as landowners) by the MDP. A share (50 per cent) of any profit will also be payable as an overage if the gross development value (GDV) threshold is exceeded following the sale or valuation of the completed scheme;
2. **Revenue Share** - a proportion of GDV paid by the MDP when the development of that phase is complete, potentially including an upfront land payment (up to 50 per cent of the residual land value (RLV)) if elected by Network Rail / DfT; or

- 3. Profit Share** - a participative risk/ profit sharing mechanism whereby a proportion of development profit is paid by the MDP when the development of that phase is complete, potentially including an upfront land payment (up to 50 per cent of RLV) if elected by Network Rail / DfT.

The landowners will jointly elect the method through which they wish to receive their returns at the point of land drawdown. This decision will be governed through the collaboration agreement decision making structure. The tax implications of each mechanism will be assessed as part of the transaction election process, recognising that DfT and Network Rail are separately constituted for tax purposes with differing corporate structures.

**Costs and liabilities** – Network Rail and DfT will incur costs both directly (procured enabling works, contract management costs) and indirectly (monies payable to reimburse MDP expenditure) through the life of the development. These costs can be further categorised between those incurred by the landowners pursuant to the development agreement and those incurred by each party in fulfilling its obligations set out in the collaboration agreement. Each of these categories of costs will be incurred at different points over the course of the project and will require appropriate treatment, at each stage, between Network Rail and DfT.

Ongoing MDP development costs will be deducted out of the proceeds of the development of each Phase with the net distributable value of any phase being total receipts less total deductibles.

The costs outlined below do not take into account any costs incurred in the procurement of the MDP (to be met by HS2 Limited) or drafting the collaboration agreement (to be met by Network Rail). Both parties will agree not to seek to recover any element of these costs from receipts generated from development activities.

Total deductibles are:

- MDP fee (balance + reimbursement) – this represents both the balance of the MDP's fees (as set out within the development agreement) incurred during the pre-outline planning phase of the contract (which have not been paid on account through the upfront stipend) and repayment of the upfront fees paid on behalf of the landowners by HS2 Ltd. If the land receipts are not sufficient to cover the MDP fee balance and reimbursement, then these costs will be rolled over to the subsequent plot or phase.
- External Contract Management Costs – external costs to be agreed by the landowners and reasonably and properly incurred by the appointed contract manager through activities associated with the contract management function in relation to overseeing the obligations set out in the development agreement and associated documents (i.e. property consultants, taxation advice and external legal support).

- Internal Contract Management Costs – internal costs to be agreed by the landowners and reasonably and properly incurred by the appointed contract manager through activities associated with the contract management function such as contract manager fees. This is initially to be fulfilled by HS2 Limited. acting on behalf of the landowners.
- Other – any other reasonable costs properly incurred in pursuing the overarching objectives of the collaboration agreement and agreed by the EDB in relation to the development of a specific plot. This is to include any tax liability borne by a single party as a result of corporate tax status (to ensure both parties are equitably remunerated) as well as costs incurred in disputes. For both examples, a single party will directly settle any costs and be reimbursed through a rebalancing of receipts.
- Enabling works costs – apportioned per plot (pro-rata across enabled phase A/B1 plots) and indexed according to the prevailing Treasury Green-book standard per cost profile to drawdown. Subject to funding being agreed this will also be apportioned per plot for phase B2.

**Obligations** – the DfT and Network Rail will be parties to, and each will undertake and discharge certain obligations under, the development agreement. Other than in respect of Network Rail enabling works, the DfT will be the principal counterparty in the development agreement vis-a-vis the MDP and has sole responsibility to the MDP for the discharge of obligations in the development agreement (except progression through the GRIP stages by Network Rail in relation to the redevelopment of existing Euston station), until drawdown of a Phase.

### **Regulatory Implications**

We recognise that this is not Permitted Business activity (as defined under the terms of our network licence). Furthermore, having reviewed the terms of our existing property activities consent, we do not believe that this is an activity that falls within the parameters of that consent. We would therefore request that ORR grants consent under condition 4.1(c) of the Network Licence to enable this activity to proceed.

Under the terms of the DfT Framework Agreement, Network Rail must also seek the relevant approvals of DfT to engage in non-permitted business activity particularly if that activity is 'novel, contentious or repercussive'. In this instance, the shareholder team at DfT are fully aware of our proposals and we have confirmation that DfT consent is not required in this instance, given the nature of DfT's involvement and the intended collaboration between Network Rail and DfT to enable this development activity.

Entry into the development agreement entitles the MDP to draw down land subject to conditions contained in the development agreement therefore draw down of land is subject to

Network Rail securing consent under condition 7. Therefore Network Rail envisages requiring condition 7 consent (general or specific, as appropriate) for the following:

- The HS2 Act gives DfT the ability to CPO land for the new station but its ability to acquire (permanently or on a temporary basis) any railway property or rights over it or to grant rights in favour of third parties requires Network Rail's prior written approval
- Where the MDP wants to develop a phase it must enter into a building agreement, building lease and an Asset Protection Agreement
- The grant of easements or dedications of property rights where necessary and as a result of entry into statutory agreements (including Section 106 Agreements and Highways Agreements).

Network Rail will go through the usual procedure to rely on ORR's existing licence condition 7 general consent or to seek ORR's specific consent under licence condition 7 as necessary at the relevant time.

Final edits are being made to the development agreement and collaboration agreement but the principles of both documents are agreed. Therefore Network Rail believes this letter should provide ORR with sufficient information in order that consent can be granted under condition 4.1(c) of the Network Licence.

Given the intention of Network Rail and DfT to enter into a development agreement in January 2018, Network Rail is looking to secure the requisite consent before the end of 2017.

If you have any questions with regard to this matter please do not hesitate to contact me.

Yours sincerely

Kara Chester  
Senior Regulatory Specialist



Department  
for Transport

Nathan Harlatt  
Euston OSD Sponsor  
High Speed Rail Group  
Department for Transport

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Web Site: [www.dft.gov.uk](http://www.dft.gov.uk)  
27 November 2017

Carl Hetherington  
Deputy Director Economic Regulation and Regulatory Finance  
ORR

Dear Carl,

As discussed on our call of 23 October I am writing to you to confirm the terms of the proposed contract for a Master Development Partner (MDP) for the Euston area and its impact on Network Rail's (NR) regulated funding settlement. I apologise for the delay in providing this note.

Both the Secretary of State (SoS) and NR will be signatories to this contract and will have rights, obligations and liabilities in relation to it. Chris Paxman, Development Manager at Network Rail, has previously given you assurances regarding the resourcing implications for NR and in particular of the NR Property Team's ability to absorb this work.

In relation to financial liabilities, the principle upfront payments due under the contract are capped at £20m and these will be met in their entirety by DfT. Any further financial liabilities will either be netted off any income generated by the development or incurred as a result of MDP services called upon at the discretion of the commissioning party (NR or DfT). NR will therefore not be obliged to incur liabilities that will not be met through income from the development.

There will be ongoing work regarding the business case for a potential redevelopment of NR station at Euston that is likely to require some element of development funding. This is an independent piece of work however and no additional liabilities will be incurred during CP6 as a result of the MDP contract.

In parallel to this contract DfT and NR will enter into a Collaboration Agreement to govern how we as land owners manage the contract between us. It sets out principles for the pooling of land, sharing of revenue, obligations and decision making.

If you wish to discuss any of this in more detail please let me know.

Yours sincerely,

Nathan Harlatt  
Department for Transport



Department  
for Transport

Nathan Harlatt  
Euston OSD Sponsor  
High Speed Rail Group  
Department for Transport

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Web Site: [www.dft.gov.uk](http://www.dft.gov.uk)  
13 December 2017

Les Waters  
Licensing Manager  
ORR

Dear Les,

I understand that you are seeking some further clarity on the £20m contribution payment I referred to in my letter of 27 November.

Firstly I can confirm that this payment to the MDP will come directly from DfT. We will not require NR to make any payment to us or net any payment we make to them in regard of this sum.

This £20m is a contribution from the Contracting Authorities, DfT and NR, to the costs incurred by the MDP in obtaining outline planning permission. We will contribute 50% of these costs up to a maximum cap of £20m excluding VAT. Any costs the MDP incur beyond this cap will go in to a deductions account to be netted against the value generated by subsequent phases of the development.

I hope this addresses your concerns. Please feel free to contact me should you require any further information or assurance.

Regards

Nathan Harlatt  
Department for Transport