

REAL ESTATE GAZETTE

**FOCUS ON:
DEVELOPMENT,
PLANNING AND
INFRASTRUCTURE**

DENMARK

DENMARK'S BIGGEST EVER
CONSTRUCTION PROJECT FACES
MULTIPLE ISSUES

ITALY

MILAN'S METRO5 PROJECT

MIDDLE EAST

THE RISE OF BUILT TO SUIT
DEVELOPMENTS IN THE UAE

SWEDEN

BUILDING PERMITS FOR HOMES
FOR ASYLUM SEEKERS IN SWEDEN

UNITED KINGDOM

RISING CONSTRUCTION COSTS

UNITED STATES

SHOULD AN OWNER LIMIT THE
ARCHITECT/ENGINEER'S LIABILITY?

AUSTRALIA

AUSTRALIA'S FOREIGN
INVESTMENT REGIME RELOADED

FRANCE

DEVELOPING AND LEASING A
DATA CENTER

ROMANIA

PROPOSALS AIMED AT
PROTECTING INDIVIDUAL
BORROWERS IN ROMANIA

**THE MORE POSITIVE ECONOMIC OUTLOOK IN
MANY COUNTRIES HAS LED TO INCREASED
INVESTMENT IN HUGE INFRASTRUCTURE
AND CONSTRUCTION PROJECTS**



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A NOTE FROM THE EDITOR



The twenty-fourth issue of the DLA Piper Real Estate Gazette highlights issues relating to development, planning and infrastructure.

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Challenging financial and humanitarian emergencies affect our sector.
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A very warm welcome to Issue 24 of DLA Piper's *Real Estate Gazette*, in which we focus on a significant part of our real estate practice: development, planning and infrastructure.

One of the most fascinating aspects of international real estate is the way in which it is continually changing to keep pace with global developments. The dramatic financial crises experienced by many countries in recent years, followed by their fragile and sometimes uneven recovery, has of course led to many significant changes in our industry. Our specialist topic in this issue provides an excellent barometer of the pace of such change.

On the one hand, the more positive economic outlook in many countries has led to increased investment being available for huge infrastructure and construction projects. Our Danish and Italian articles provide two examples of this. In Denmark, the authors highlight the legal issues surrounding the construction of the Fehmarnbelt Tunnel, which will constitute an important part of Danish infrastructure connecting the eastern part of Denmark with Central Europe (see page 8), whilst in Italy (see page 12), the authors look at the various financing and contractual issues affecting Milan's Metro5 project. Similarly, our Turkish article (page 28) notes that Turkey's construction sector has been at the forefront of the country's recent economic development, leading to their being ranked as the country with the second highest number of contractor companies in the world, with huge potential for growth in the real estate sector.

On the other hand, challenging financial and humanitarian emergencies, such as the European migrant crisis, also affect our sector. In Sweden, the increasing number of asylum seekers has created an urgent demand for housing and our article on page 26 describes the efforts of the Swedish government to tackle this issue, and examines the extent to which building permits must be obtained when homes are built, or existing facilities are altered, for asylum seekers. Our Spanish article (page 25) notes the impact of the financial crisis on property sales and construction levels and discusses the effect of a construction company's insolvency on other parties within a construction project with whom agreements were already in place.

Other articles dealing with general real estate matters include an examination of Australia's foreign investment regime (page 36); the issues surrounding developing and leasing a data center in France (page 42); and proposals aimed at protecting individual borrowers in Romania (page 44).

We hope that amongst such a wide range of topics, there will be something of interest for all our readers.

Olaf Schmidt, Co-Chair, Global Real Estate Sector

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DEVELOPMENTS IN CZECH CONSTRUCTION LAW

JAKUB ADAM AND MAREK STRÁDAL, PRAGUE

Without any doubt, the recent solid performance of the Czech economy has helped to reignite the country's real estate market including property development. However, the legal and administrative framework for the development of real estate projects still suffers from numerous shortcomings, the rectification of which could boost growth in the real estate sector further.

A perennial problem is the length of time taken by the relevant administrative procedures. Both the environmental impact assessment (EIA) and all stages of construction permitting procedures—often taking several years where there is local resistance to a building project—have the potential to seriously delay the preparation phase of any project. The building occupancy permitting process is also unreasonably complicated. These deficiencies are addressed by a recent amendment to the EIA regulation and a proposed amendment to the Czech Construction Act.

Environmental impact assessment

The EIA amendments were adopted with effect from 1 April 2015 in response to the European Commission's criticisms of the Czech EIA regulation. The first change to note is that where the fact-finding procedure concludes that a project is not subject to an EIA assessment, a corresponding administrative resolution is issued which may be the subject of a legal challenge. Where it is found that an EIA assessment is required, this can result in a binding opinion effective for five years, which also receives a "Coherence Stamp" verifying the compliance of the project application with the binding opinion for

the purposes of subsequent proceedings.

Another change that is not welcomed by developers is the ability of environmental associations to participate in EIA proceedings with the introduction of the concept of "affected public". Under these provisions, parties are given a right to appeal a resolution which excludes a project from EIA assessment or even to bring an action for the annulment of such a resolution. It should be noted that environmental associations enjoy the same rights in subsequent proceedings.

One of the practical effects of these amendments is the shift in the qualification criteria for assessment. Developers may welcome the mitigation of fact-finding procedures in relation to certain projects including construction of storage complexes with a total area exceeding 10,000 sq. m. of built-up area (the previous threshold was 3,000 sq. m.), or projects to build retail facilities with a total built-up area exceeding 6,000 sq. m. (the previous qualification criterion was set at 3,000 sq. m.), and further parking or garage facilities with a capacity exceeding 500 parking spaces in total for the whole project (raised from the previous total of 100 parking spaces).

Construction law

Since 2015, the Czech Ministry of Regional Development has been working on a major amendment to the Czech Construction Act that should improve the development and construction legal environment significantly and thus satisfy the critics who complain that the administrative processes are unreasonably long and complicated, the set deadlines for documentation renewals are too short, and the administrative court review can last for an unreasonably long period, causing



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One of the most significant changes contemplated is the integration of the zoning and building permitting procedures into a single ‘coordinated permitting procedure’.

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instability and uncertainty.

One of the most significant changes contemplated by the intended amendment is the integration of the zoning and building permitting procedures into a single “coordinated permitting procedure”. It may even be possible to amalgamate the coordinated permitting procedure with the EIA assessment in the future, which would both combine the opinions issued within the proceedings and also enhance cooperation between the various authorities involved. The new coordinated procedure would apply to stand-alone construction projects as well as building complexes. Clearly, combining proceedings like this would be a real step towards improving communication between authorities and ultimately simplifying and accelerating the permitting procedures while still protecting the public interest.

Additionally, the amendment introduces a single type of occupancy permit called the “occupancy consent”. Compared to the current practice where an occupancy permit is issued only on removal of construction defects identified in course of the pre-occupancy building inspection, the “consent” will be issued in all cases. It is proposed that the authority will be entitled to initiate full occupancy permitting proceedings if conditions for occupancy are not met, which would then result in the issuing of binding conditions for removal of defects. Occupancy consent would then be issued once the defects are removed.

The amendment was expected to come into force in 2017, however, it is likely that that date will be delayed.

DENMARK'S BIGGEST EVER CONSTRUCTION PROJECT FACES MULTIPLE ISSUES

MICHAEL NEUMANN, COPENHAGEN



Introduction

In March 2016, a majority of political parties in the Danish Parliament agreed on the contracts regarding the future tunnel between the island of Lolland in the southeast of Denmark and the island of Fehmarn in the north of Germany (the Fehmarnbelt Tunnel). The tunnel, which will be the longest immersed tube in the world, is expected to be finished in 2028 and will constitute an important part of Danish infrastructure connecting the eastern part of Denmark with Central Europe. However, a series of legal disputes may disrupt the process and delay the project.

Northern Europe's biggest construction project

With the agreement of the different contracts regarding the Fehmarnbelt Tunnel, a big step has been taken towards establishing a permanent connection between the eastern part of Denmark and Germany. So far, it has only been possible to commute between the countries by ferry or over the border in the western part of Denmark, Jutland. Copenhagen, however, is situated in the eastern part of Denmark, and travelling from Copenhagen to Germany has been difficult until now. Consequently, the

establishment of a permanent connection across the Fehmarnbelt has been a subject of discussion for many years, for political as well as commercial reasons. Although the project has generally received wide acceptance from the Danish public, some have argued that the project is too expensive. However, the Confederation of Danish Industries and the Confederation of Danish Enterprise have stressed the importance of the project, pointing out that it will improve the infrastructure between Scandinavia and the rest of Europe, and significantly reduce traffic on the Great Belt Bridge between the eastern and western parts of Denmark.

Amidst some disagreement, nevertheless the Danish and German governments agreed in June 2007 to cooperate on this project, and in September 2008, the Danish and the German Ministers for Transport signed a treaty regarding the establishment of a permanent connection between the two countries. Four different designs for the connection were considered: two types of bridges and two types of tunnels. In 2011 a tunnel designed as an immersed tube was chosen.

This tube will be Northern Europe's biggest construction project to date and the biggest construction project in Danish history. The expected costs of

€7.4 billion will not trouble Germany, although the construction works on land in Germany and Denmark will be paid by each country respectively. As those using the tunnel will be charged a fee to do so, the project is expected to pay for itself 36 years after its completion.

Competitive dialogue

A project of this size is naturally highly complex. Consequently, the Danish authorities have used a type of open tendering called "competitive dialogue". This type of open tendering may only be used under special circumstances, including the situation when the contracting entities are not able to determine the project's technical specifications sufficiently, and/or when the contract cannot be tendered without a preceding dialogue.

Femern A/S, managing the Danish government's interests and fully owned by the Danish government, has chosen this type of open tendering, as it is considered to be both technically and economically the best solution for a project of this size and complexity. It should be noted that this type of open tendering constitutes an exception to the general rule of prohibition of negotiations set out in the EU Public Procurement Directive.

Femern A/S has chosen the "Design



and Build” method, meaning that Femern A/S is responsible for preliminary studies, environmental examinations, geotechnical studies, including studies regarding noise, dust, water quality, waste management, access, etc. Having conducted these studies, the different contractors are responsible for the detailed design, the choice of methods and the construction of the project. The contractors must be able to continuously document the quality of their work and ensure that the work meets the functional requirements laid out by Femern A/S.

Femern A/S has divided the project into four engineering contracts and, in May 2013, it pre-qualified nine different contractor consortiums. The bidding companies were all major international players. The final choice of contractors was made in March 2016.

Legal issues arising

Despite being approved by the Danish Parliament, the biggest construction project in Danish history still faces some serious obstacles which may well further complicate the establishment of the tunnel.

First of all, Germany still needs to give its environmental approval. This is expected to be given in 2019 at the latest. Regardless of this being seen

as a formality by some, a delay in such approval being given will result in increased costs. This is because the contractors are entitled to the equivalent of approximately €20 million for each year the tunnel is delayed. In an analysis conducted by Femern A/S themselves, it is estimated that delays in the construction process for two years, aside from the already assumed reserves, will amount to the equivalent of approximately €67 million annually.

When the environmental approval is given, there is a significant risk that one or more German environmental associations, including the Nature And Biodiversity Conservation Union (NABU) with almost 600,000 members, will sue the German government for its decision to grant permission for the project. The crucial factor will then be if the court grants the action suspensory effect, as this might result in further delays to the project. It should be noted that such suspensory effect was granted by the Federal Administrative Court in Leipzig in 70 per cent of all cases before it in 2014. Further; a possible ruling by the court supporting the environmental associations could place the project's future in serious jeopardy.

In the summer of 2015, the EU granted the project state aid. This gave rise to a complaint

from the shipping company, Scandlines, which operates the ferries between Rødby and Puttgarden, that the granting of state aid was anti-competitive. The European Commissioner for Competition, Margrethe Vestager, has rejected this claim, stating that the tunnel will make travel time significantly shorter between Germany and the eastern part of Denmark, and the other Nordic countries. Thus she has argued that the establishment of the tunnel will ultimately benefit both the public and the economy. However, Scandlines Danmark and Scandlines Deutschland have brought an action against the European Commission, arguing that the decision to grant state aid should be annulled on the basis that it is a breach of EU law. The case is currently before the Court of Justice of the European Union.

Conclusion

Whilst agreement in the Danish Parliament was a big step towards the establishment of a Fehmarnbelt Tunnel, the range of problems described above may well complicate matters and lead to serious delays in completion of the project. Thus the biggest construction project in Danish history looks set to have significant political and economic ramifications before it is completed.

Horten is DLA Piper's focus firm in Denmark.

CONTRACTS FOR THE COMMISSION OF ARCHITECTS AND ENGINEERS IN GERMANY

MARTIN HALLER AND MANUEL INDLEKOFER, MUNICH

The commission of architectural and engineering services in Germany is highly regulated by the official schedule on services and fees for architects and engineers (Honorarordnung für Architekten und Ingenieure, HOAI). The principal objective of the HOAI is to contain price competition in the market. For this purpose, the HOAI provides for a binding services and pricing schedule which must be adhered to when commissioning architectural and engineering services. In-depth knowledge of the services and pricing scheme is essential to reduce the risk of entering into void fee agreements, which could ultimately lead to higher fees for the same services.

Scope of the HOAI

There are criteria to be met in relation to: the contractor; place of performance; type of commissioned services and the amount of chargeable costs before the binding pricing scheme of the HOAI applies.

Any deviation from the pricing scheme is generally void. However; if the commission of services does not fall within the scope of the HOAI, fees can be negotiated freely between the parties, generally in the form of a lump sum fee, per hour remuneration or per hour remuneration with a cap.

The contractor

The HOAI only applies if a contractor is commissioned that has its location or head

office in Germany. The commission of an architect or engineer in a location outside of Germany for services that will be used in Germany are not within scope of the regulation.

Beyond that, formal requirements for the contractor are limited. Thus, not only qualified architects and engineers fall within scope of the HOAI, but every person that performs services provided for in the HOAI.

Place of performance

For the HOAI to apply, it is essential that the service is performed in Germany. For example, the HOAI would not be applicable in the case of a German architectural firm that is hired to perform services outside of Germany.

Type of commissioned services

The HOAI gives performance descriptions for the different services that can be commissioned, which include the following:

- Zoning plans,
- Landscape and open space plans,
- Building planning,
- Interior design,
- Engineering construction,
- Traffic facilities,
- Structural planning, and
- Technical equipment.

These performance descriptions are the basis for the applicable fee schedule provided in the HOAI.

Chargeable costs

The HOAI is only applicable in a specific range of estimated costs (for the production, upgrading or refurbishment of the object). If these chargeable costs are less than €25,000 or more than €25 million, the pricing scheme of the HOAI is not binding.

Regulatory content of the HOAI

As mentioned above, the HOAI provides for a binding pricing scheme only for the commission of architectural and engineering services. The HOAI does not make any other provisions regulating the contractual relationship between the purchaser and the contractor. In general, all of the contracts for the commission of architectural and engineering services will constitute contracts for services (Werkvertrag), to which the relevant provisions of the German Civil Law Code (BGB) apply.

Calculation scheme for HOAI services

The calculation scheme for the commission of architectural and engineering services is generally dependent on the following three key points:

- (1) Chargeable costs,
- (2) Performance description and underlying fee schedule, and
- (3) Service phases.



The calculation scheme for applicable fees for commissioned architectural and engineering services is highly complex, so we will highlight only the basic elements of the scheme here.

Chargeable costs

The chargeable costs are the estimated costs for the production, upgrading or refurbishment of the object, subject to the commissioned services. These chargeable costs are the reference point for the calculation of the applicable fees according to the performance description and underlying fee schedule (see below). The determination of the chargeable costs is regulated in the HOAI in great detail.

Performance description and underlying fee schedule

For each of the performance descriptions described above, the HOAI provides for an underlying fee schedule, which determines a range for the applicable fees, according to the chargeable costs. Within this fee range, the contracting parties are free to determine the applicable fee.

In addition, the fee schedule leaves room for more flexibility in the determination of the fees by providing different fee ranges, depending on the difficulty of the commissioned services:

- **Fee range I:** very minor planning requirements
- **Fee range II:** minor planning

requirements

- **Fee range III:** average planning requirements
- **Fee range IV:** above average planning requirements
- **Fee range V:** very high planning requirements

The application of the respective fee band must be determined according to the descriptions and examples provided for planning services in the HOAI. However, in borderline cases, the parties can influence the applicable fee by agreeing on the appropriate fee range.

Service phases

The fee determined according to the performance description and underlying fee schedule is the fee for the entire commission of planning services for the planning of the respective performance description. In most cases, the architect or engineer will only be instructed to perform a single service in the respective performance description. For this reason, the HOAI subdivides the services for each project description into service phases and provides for a proportional share for each service. This percentage is the basis for the fee applying to the commissioned single service. For example, for the performance description "building planning", the following service phases apply:

- **Phase 1:** Preliminary assessment: 2%
- **Phase 2:** Preliminary design: 7%

- **Phase 3:** Conceptual design: 15%
- **Phase 4:** Approval planning: 3%
- **Phase 5:** Implementation planning: 25%
- **Phase 6:** Preparations for awarding contracts: 10%
- **Phase 7:** Assistance with awarding contracts: 4%
- **Phase 8:** Object monitoring: 32%
- **Phase 9:** Site supervision and documentation: 2%

Which services are included in each service phase is also detailed in the HOAI. If the parties only want to apply single services in a service phase, they are generally free to decide which proportionate share of the above percentage should apply for the service.

Parties' influence on the HOAI fees

It is clear then that the HOAI provides for a strict pricing scheme which is binding on the purchaser and the contractor. However, there does remain some scope for the contracting parties to influence the amount to be paid. This must be borne in mind during negotiations of a contract for the commission of architectural and engineering services. Otherwise, parties may find themselves with a void fee agreement, and the architect or engineer entitled to claim a higher fee for services after the fact.



MILAN'S METRO5 PROJECT

UGO CALÒ AND RICCARDO PAGOTTO, MILAN

Metro5 S.p.A. is the concessionaire for the design, construction and operation of Line 5 of Milan underground network (referred to in this article as the "Project"). The successful completion of Metro5 is significant for a number of reasons. First of all it is the most visible public-private partnership (PPP) transaction in the Italian market in recent years and the first combination of a project finance loan and a project bond under the new Italian Project Bond law. Furthermore, the Project has captured the interest of a large number of banks and investors active in the European infrastructure market, confirming the bankability of well-structured PPP transactions and also the appeal of long-term, Italian sub-sovereign risk for foreign players.

Project description

The Project relates to the construction and operation of the fifth underground line of the Milan network connecting the stations of San Siro and Bignami, in the West and North of Milan respectively.

Line 5 is an underground driverless light metro system, comprising 19 underground stations for a total length of circa 12.8 km. A fleet of 21 four-body trains carry out the service.

Line 5 crosses a densely populated area which currently suffers from serious shortcomings as regards public transport. It also serves the Milan soccer stadium, located in the peripheral quarter of San Siro, where massive events often take place.

The construction of this infrastructure has been split in two lots, with different

construction periods:

- Phase I (from Bignami to Garibaldi FS): construction started in August 2007 and the commercial operation of the entire stretch started in March 2014;
- Phase II (from Garibaldi FS to San Siro Stadium): construction started in August 2010, the commercial operation of five stations started in April 2015 (in time to serve the Milan Expo 2015 event), while the remaining five stations were completed in October 2015.

The sponsors are Astaldi, Alstom Ferroviaria, Ansaldo STS, AnsaldoBreda and ATM (the Milan public transport operator, which also acted as EPC contractors).

From two concessions to a unified structure

To accommodate the phased approach to the Project, the construction and operation of the two lots have been regulated under two independent concession agreements, with two separate SPVs (Metro5 and Metro5 Lilla, ultimately owned by the same sponsors) and different financing structures.

The Project started in June 2006 when, after a public tender, the Grantor and Metro5 signed a concession agreement for the design, construction and operation of Line 5, from Bignami station to Garibaldi station (Phase I). The original concession agreement envisaged possible extensions to the infrastructure.

In December 2007, a credit facility agreement was signed ("Original Financing") between Metro5 and a group of banks for a total amount of €275.6 million with the sole purpose of financing Phase I.

In July 2010, the Grantor decided to extend the Line 5 from Garibaldi Station to San Siro Stadium. Thus, on 2 February 2011, the Grantor and Metro5 entered into a new concession agreement for the construction and operation of the extension of Line 5 (Phase II). In order to preserve the interests of the existing lenders under the Original Financing, Metro5 established Metro5 Lilla (an SPV fully owned by Metro5) that became the concessionaire for the Phase II, thus creating a perfect ring fence around the two concession agreements.

Metro5 Lilla funded the construction costs through: (i) equity, (ii) public grants, (iii) bridge loans and (iv) delaying the payment terms to the construction consortium.

The Grantor and the concessionaires, Metro5 and Metro5 Lilla (individually known as the "concessionaire") agreed to consolidate the two existing concessions into a single agreement ("*convenzione unica*") thereby establishing unified regulation of the entire infrastructure.

This process of moving from two separate concessions to a new unified structure represented one of the most challenging aspects of the Project's financing and required some complex restructuring.

In particular, Metro5 had to manage almost in parallel the following activities, involving different parties:

- Merger between Metro5 and Metro5 Lilla;
- Entering into a *convenzione unica* replacing the two stand-alone

concession agreements;

- Negotiation of unified EPC and O&M contracts replacing the existing ones; and
- Arranging a new financing package tailored to the financing needs of the unified project and appropriate for the *convenzione unica*.

Financing structure: the combination of project loan and project bond

The financing required (excluding VAT) was around €1.6 billion and has been funded by a combination of: (i) public grants (circa €824 million, VAT excluded), (ii) operating cash flow, (iii) sponsors' equity and (iv) funding from banks and institutional investors.

Articles 157 and following of the Italian Code of Public Contracts allow special purpose entities and companies that have been awarded PPP contracts to issue project bonds. However, some important changes were made by Law Decree 133/2014. In particular, although project bonds remain reserved to qualified investors, this category has been extended to companies controlled by qualified investors.

Moreover, in 2014, changes to the tax regime applicable to security instruments and the interest payable on project bonds were introduced, namely:

- i. the issuance and the transfer of any security instrument relating to project bonds is subject to fixed registration taxes of €200;
- ii. the interest on project bonds is subject to a concessional tax rate of 12.5 per cent (instead of 26 per cent).

Additionally, the bankability provisions originally applicable only to the banks financing provision of infrastructure or of a public service, are now extended to the bondholders.

In light of these changes, the sponsors and the mandated lead arrangers (MLAs, that is, the banks which arranged the financing) decided to offer an institutional tranche to investors.

The financing envisages the combination of a €150 million institutional tranche and a €430 million project financing ("Project facilities").

The Project facilities included: a €350 million base facility, a €30 million stand-by facility and a €50 million VAT facility and were provided by: Banca IMI, BBVA, BNPP, CACIB, MPS, Natixis, Societe Generale

CIB, UBI Banca, Unicredit. Cassa Depositi e Prestiti also participated as lender with a quota of €100 million.

The institutional tranche, which is unrated and unlisted, has been privately placed with: Aviva, Intesa Vita, La Banque Postale AM, SCOR e UnipolSAI.

The hedging strategy is also atypical for this transaction. In addition to the novation of the four existing deep-in-the-money swaps entered into in 2007 in connection with the original financing, new hedging contracts have been entered into by Metro5 in order to hedge 80 per cent of the interest rate risk of the term facilities provided by the banks until 2030, taking into consideration the cash sweep effect.

Furthermore, as the notes are exposed to the floating interest rate risk, Metro5 entered into specific swaps dedicated to the institutional tranche. Since the notes do not benefit from the cash sweep mechanism, the relevant swaps tenor expires in 2035. As a consequence, this hedging product is likely to become an "orphan swap" for the lenders that are also hedge providers. Specific protection for the orphan swap providers has thus been included in the intercreditor agreement.

Contractual structure

The contractual framework is quite standard for similar non-recourse transactions and allows Metro5 to allocate the main risks to third parties both during construction and operation through, among others: a single EPC contract (contractors are the same sponsors) and a specific operation and maintenance agreement (O&M) contract (with ATM, one of the sponsors). Those commercial contracts grant a strong pass-through of the concessionaire's obligations and risks under the *convenzione unica*.

The *convenzione unica* is a typical PPP concession agreement for the design, construction and operation of public works. It is regulated by the Italian Public Contracts Code and is one of the first examples of PPP in Italy with a benefit/cost sharing mechanism between the grantor and the concessionaire linked to the actual terms of the underlying financing. Under the *convenzione unica*, the regulatory financial plan is rebalanced to take account of any material deviation of the actual financing structure from the financial assumptions on which the regulatory financial plan is based.

THE RISE OF BUILD TO SUIT DEVELOPMENTS IN THE UAE

HELEN HANGARI, DUBAI

“Build it and they will come” has been a popular mantra in Dubai property circles arising from a time of frenetic building activity in the Emirate leading up to the global recession in 2009. With a slow shift to a more mature real estate market in Dubai there has been an increase in occupiers seeking build to suit deals in order to achieve their requirements for office or industrial space—more a case of “build it upon demand for specific occupiers and they will come.”

The key benefit to corporate occupiers of the build to suit model is that they are able to occupy space which is built according to their specification and which was presumably not otherwise available in the location. Other benefits include that the development phase is risk free as the developer takes on the risks associated with development work (the upside for the developer being that the build to suit model is demand driven and therefore it has an identified purchaser or tenant for the building before it commences construction). Corporate occupiers also benefit from the transaction being off balance sheet during the construction phase. However, there are a number of important factors that a corporate occupier needs to consider when contemplating a build to suit arrangement in Dubai:

- The timing of the move of employees and assets to the build to suit space may be determined by the expiry or termination of leases of other property in the same area or region. Due to Dubai’s landlord and tenant laws, the vacating of a property occupied pursuant to a lease requires action many months before the date of expiry. Therefore, the ability of the contractor to deliver the desired building to the specification required and on time is essential to enable the occupier to take

such steps to vacate with certainty. Occupiers should therefore seek to have approval rights over the identity of the contractor and monitoring rights during the construction phase so that an early alarm is sounded if delays become likely.

- In Dubai the ownership of real estate by companies which are not wholly owned by United Arab Emirates (UAE) citizens is limited to certain areas (known as designated areas). If the desired commercial space is not within a designated area then the occupier will be limited to obtaining a leasehold interest rather than acquiring ownership of the completed space. Whilst a leasehold may indeed be more desirable to many occupiers, for those seeking freehold ownership, their location options will be limited to the designated or investment areas.
- If the occupier proposes to form a special purpose vehicle to acquire its interest in the building when completed, it is common practice that a parent company guarantee will need to be provided to the developer. Therefore, the occupier will need to consider which company can give such a guarantee (ie how far up the corporate chain) and this will need to be agreed with the developer and the lender providing construction finance.
- The bank providing financing to the developer is likely to seek an assignment of the benefit of the transactional documents which commit the occupier to taking ownership of, or a lease of, the space when completed. Therefore, the occupier will need to liaise with the bank and the developer in this regard.
- Given that the build to suit building is likely to be constructed on previously undeveloped land in



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The rise of build to suit developments in Dubai is one of the signs of a more mature, increasingly sophisticated real estate market.

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Dubai, surrounding infrastructure will need to be developed as part of the project, for example, surrounding roads, car park, etc. The responsibility for providing such infrastructure may fall to the developer or a “master” developer if the land forms part of a master community. Either way, an occupier will need comfort that the infrastructure will be completed before it is obliged to take ownership of, or a lease of, the building.

Developers undertaking a build to suit development have various options for structuring the deal. For example, the developer may acquire the land to be developed and then sell/lease it to the occupier upon completion, it may enter into a joint venture with the land owner or the occupier may acquire the land and appoint the developer:

Taking each of these options in turn:

- Acquiring real estate in Dubai currently gives rise to a transfer fee of 4 per cent of the purchase price. Therefore, if the developer acquires the site and then sells it to the occupier upon completion, the total transfer fees payable will be considerable. The developer will need to have the occupier contractually committed to the deal before it incurs the cost of acquiring the land and pays the transfer fees. Whilst some parties will accept incurring such amounts in transfer fees, others may seek alternatives such as the occupier acquiring the land from the outset.
- Where a landowner has land available which it is not developing itself due to a lack of expertise or financial ability, a joint venture between the landowner and a developer may be possible. In this scenario, a joint venture company will be formed and the landowner will contribute the land and the developer

will provide some equity and its expertise. With this model, the exit options for each party will need to be carefully thought through as the landowner and developer’s interests may not be aligned. For example, if the occupier is to take a long lease of the completed building, the landowner may be happy to take the rental income and be less interested in selling the building. However, the developer may be more inclined to sell the completed building to obtain the profits which can then be used for further developments.

- The parties may agree that the occupier acquires the land from the outset and simply appoints the developer to complete the project. This will reduce the overall transfer fees and may result in a lower overall cost to the occupier. However, this model requires the occupier to have the financial ability to acquire the land and pay the transfer fees some time before it can occupy the desired building.

The final major player in build to suit developments in the UAE is the lender, which must be a bank licensed by the UAE Central Bank. The lender will need to be satisfied with the tenant’s covenant strength and the ability of the contractor to complete the development on budget, on time and in accordance with the agreed specification.

The rise of build to suit developments in Dubai is one of the signs of a more mature, increasingly sophisticated real estate market and a sign that large companies are taking a more long term view of their business in the region. For these reasons, it is a very welcome trend in the market.





CONTRIBUTIONS TO PUBLIC INFRASTRUCTURE IN DEVELOPMENT PROJECTS IN NORWAY

tone gjertsen, oslo

An important part of any major construction or real estate development project is the cost of establishing public infrastructure. In Norway the trend is that the public authorities expect all or most of these costs to be covered by the private developer.

This is mainly achieved by the existence of zoning provisions which prevent erection of commercial buildings before all public infrastructure is established. In the Norwegian Planning and Building Act the local authorities are given a fairly wide discretionary right to adopt such provisions. It is generally thought that there is no express requirement that the cost of infrastructure be proportional to the actual value of the development. The local authority has only to prove that the infrastructure is necessary and connected

to the planned buildings. It is only when it enters into a development agreement with the local authority that the developer can make an accurate assessment of proportional cost. Most local authorities do, however, take into account the size of the development in the zoning provisions, but they are not legally bound to do so.

Before getting involved in a real estate development project it is important to be clear as to the infrastructure that will be required. Typical zoning requirements are establishing roads, walkways, play areas, parks and similar infrastructure. These may be costly elements, but it should be fairly easy to get an overview of what is required both with regards to scope and quality.

However, developers must also be aware of the statutory requirements of the Planning and Building Act in order to have the full picture of possible costs. Section

18-1 of the Act states that before any part of a site can be partitioned or the property developed, public roads, water and sewage leading up to and past the property must already be in place. A variety of limitations in scope and standard are stated in the section, but if existing roads, water or sewage do not meet this standard, the clause may result in considerable costs. The section does not limit or define the necessary length of improved roads, water or sewage. According to case law, improvements must start from where the road or pipe network are fully developed pursuant to legislation and the applicable zoning plan, and up to and along the property being developed. In many cases this can mean long distances, often greater than the zoning provision suggests. The law does not require coordination between the statutory provisions in section 18-1 and



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The zoning provisions do not necessarily provide a comprehensive overview of the actual obligations and can give a misleading impression of what the real costs will be.

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zoning provisions.

In this author's experience neither developers, contractors nor the local authority's own planners are sufficiently aware of this clause when zoning plans are prepared. This means that zoning provisions are not adapted to the additional statutory requirement, and that section 18-1 may apply in addition to the measures that are found in the plan. This lack of awareness of section 18-1 may lead to unexpected costs, as well as difficulties with complying with zoning plan requirements.

In many cases the zoning provisions are an amalgamation of the requirements under section 18-1 and other requirements. The inclusion of some, but not all, of the measures that can be demanded under section 18-1 in the zoning provisions may create significant uncertainties. Did the local authority intend that some measures

need not be complied with, or was it just unaware of them?

Thus, it is important to be aware that the zoning provisions do not necessarily provide a comprehensive overview of the actual obligations and can give a misleading impression of what the real costs will be.

The current Planning and Building Act does not allow local authorities to waive section 18-1 in a zoning plan, such as it does in many other areas, for example, in the placement of buildings. It is submitted that the law could be improved here with a requirement that the zoning provision must provide a complete overview of the measures to be fulfilled. In addition, we would support an amendment of the Law to allow local authorities, in specific circumstances, to waive section 18-1 in the zoning provision. This would be beneficial for both local authorities and developers. A

requirement that the cost of infrastructure provided by private developers must be proportional to the value of the development would also be a step forward.

Finally, it is important to be aware of the connection between the section 18-1 requirements and the cost-sharing system provided by the Planning and Building Act. Only the costs of measures strictly required under section 18-1 may be included in a compulsory cost-share. There have been some unfortunate examples where zoning provisions were prepared in such a way that a compulsory cost-share was not possible, or could not be fully applied.

It is essential, therefore, that all those involved in planning or developing properties be fully aware of section 18-1 and acknowledge that the zoning provision does not always provide a clear picture of what the developer must contribute.

PLANNING RESTRICTIONS UNDER THE REGENERATION ACT

PAWEL BIALOBOK, WARSAW

The Regeneration Act, which came into force partially on 18 November 2015 and partially on 1 January 2016, has created new tools for local governments to undertake the comprehensive renovation of deprived areas.

In terms of the Act, a deprived area is defined as an area in which there is a concentration of negative social phenomena, such as unemployment, poverty, crime and poor education.

If the municipality determines that an entire area suffers from these negative phenomena (or part of an area suffers from a particular concentration of such phenomena) and this has a significant impact on the development of the local area such that the municipality deems it necessary to carry out redevelopment works, it may designate the area as a "regeneration area" pursuant to the Act.

Regeneration areas are created via resolutions passed by municipality councils. After the area has been identified as being one which requires regeneration, the municipality (in Polish: *gmina*) must create a regeneration plan, containing among other items, a description of the measures necessary to tackle the negative phenomena and the predicted results of these measures.

Local regeneration plans

The Act introduces some new legal concepts concerning real estate planning and development as well as the structure of real estate transactions. One of these concepts is a local regeneration plan introduced by the Polish Act dated 27 March 2003 on Zoning and Spatial Development (referred to in this article as the Zoning Act), based on the Regeneration Act.

A local regeneration plan is a special form of local zoning plan which covers only those areas requiring regeneration. The plan

is adopted via resolution by the municipality council. In addition to the elements required for the local zoning plan specified in the Zoning Act, the local regeneration plan should include (depending on the individual needs of each project):

- principles of zoning composition of the new buildings and coordination of the planned development with the existing buildings
- issues relating to the facades of buildings
- prohibitions and restrictions regarding commercial activity to be carried out within a regeneration area
- maximum area to be committed to commercial buildings.

Additional investments

A local regeneration plan may also create additional limitations with respect to the planning and development of real estate investments and these should be reviewed carefully before any purchase of real estate. One of these limitations is an obligation to undertake supplementary investment works in addition to the main investment works.

Under the Regeneration Act, the local regeneration plan may impose a condition on investors that in order to undertake the main investment works, the investor may be obliged to undertake—at its own expense—supplementary investment works, which may take the form of technical, social or residential infrastructure (as described in the local regeneration plan). The supplementary investment may also take the form of the non-residential premises designated for the purpose of conducting cultural, social, educational or sport activity by the entities (the main goal of which is not generating an income) conducting the activity on the regeneration area.

Subsequently, the supplementary investment must be transferred free of

charge to the municipality. In order to secure the proper development of a supplementary investment, the investor and the municipality must enter into an agreement which should contain, *inter alia*, the technical details of the investment, scope of the construction works to be performed, and the date of the handover of the supplementary investment. The agreement must be concluded in the form of a notarial deed in order to be valid and constitutes a condition for the investor to obtain a construction permit for the main investment. Furthermore, the handover of the supplementary investment for the benefit of the municipality is necessary for the investor to commence use of the main investment.

Other planning limitations

A resolution on the creation of a regeneration area may also introduce a prohibition on issuing zoning decisions (in Polish: *decyzja o warunkach zabudowy*) which is an indispensable element of an investment's planning process if the area is not covered by the local zoning plan. The municipality may establish the prohibition within the regeneration area if its development and coverage by zoning plans indicate that if the prohibition is not introduced, this may lead to adverse changes in the area, exacerbating the negative phenomena that form the basis for the creation of the regeneration area in the first place.

Municipality's pre-emption right

In the resolution on the creation of a regeneration area, the municipality may also establish a pre-emption right over all the buildings situated within that area. This will significantly affect the structure of any transactions concerning buildings located in the regeneration area. If a building is scheduled to be sold as a part

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of an asset deal, the pre-emption right will affect the structure of the transaction itself, ie a conditional agreement on condition that the municipality does not exercise its pre-emption right will have to be concluded before the transfer of the real estate. The municipality has one month from receiving a notification of the content of the conditional agreement to exercise its pre-emption right. The notary preparing the notarial deed containing the conditional agreement is obliged to notify the municipality of the conditional sale agreement. The pre-emption right may be exercised for a price agreed by the parties in the conditional agreement. If the municipality does not exercise its pre-emption right within the timeframe, then the agreement transferring the real estate may be concluded.

To date, the majority of municipalities in Poland have not adopted any resolutions

establishing regeneration areas. However, it is likely that most of the major cities in Poland will adopt resolutions in the near future. Regeneration areas are likely be established in cities and old towns, often areas blighted by high levels of poverty and crime. Clearly then, in the light of the above, the question of whether a target piece of real estate is, or will be in the future, located within a regeneration area should be confirmed in the course of a due diligence review in order to ensure that the prospective deal is properly structured.

Parties active on the real estate market have reacted in various ways to the introduction of the Regeneration Act. While accepting the seriousness of the problem of deprived areas in Polish cities and the need for municipalities to take positive action, the Regeneration Act has come in for some criticism for giving municipalities too much freedom in establishing pre-emption rights.



THE NEW PLANNING FRAMEWORK IN PORTUGAL

LUIS FILIPE CARVALHO AND MARIA BARAO ASSIS, LISBON

The public policy on Land and Country Planning was revised in 2014 when the new General Law for Soils, Land Use and Urban Planning (Law 31/2014) came into force on 29 June. The aim of this Law was to boost the role of local authority plans and to simplify the town planning and management system.

The structure of the system of land management was substantially changed. There are now two types of town planning management instruments: (i) Territorial Programmes, which are issued by central government and can include national programmes of land use planning policy, and regional and special programmes; and (ii) Territorial Plans, which are local authority initiatives and include the local directory plan, the town plan and the detailed plan. The Law also introduced an inter-local authority master plan which excludes the possibility of approved plans of the same type on a local level.

While Territorial Programmes are binding on public bodies, the municipal directory plan, town plan, detailed plan and inter-municipal master plan directly bind both public and private entities.

The Law also establishes that Territorial Plans should be consistent with Territorial Programmes. The land use special plans have three years to be incorporated into the municipal directory plans (from the time the Law came into force) and the existing instruments of territorial





management shall be subject to the Programme or Territorial Plan, depending on which is more suitable for its purpose. Again, the main purpose behind the change is to simplify town planning. However, there will be changes to the management plans (that are still in force) so parties are strongly advised to be aware of the changes already made and those that are forthcoming.

The Law has also abolished the concept of urban expansion since current public policy supports urban regeneration instead as the preferred means to develop cities.

In addition the Law provides some important management instruments to be carried out by local authorities (on a municipal or inter-municipal level). Regarding the use of soil, the Law gives the right to regulate its use exclusively to local authorities. Local authorities also have the duty to extend, alter or review the constraints on specific land use resulting from public utility easements, such as RAN (National Agricultural Reserve) and REN (National Ecological Reserve).

Furthermore, it falls to public bodies to identify the territorial areas which are to be regenerated. It is then for private entities to carry out development work identified as necessary for urban regeneration.

There are various urban regeneration incentives to take into consideration.

First, there are certain tax exemptions, such as the exemption from municipal

tax on charged transmissions of immovable property (IMT) to the first charged acquisition of urban regenerated property which is used exclusively for residential purposes and located in an Urban Regeneration Area. Additionally, regenerated urban properties will benefit from an exemption from municipal tax on immovable property (IMI) during the first five years after the regeneration, renewable for the same period.

It is also possible to deduct from taxable income, for personal income tax purposes, 30 per cent of the regeneration expenses, up to a limit of €500 and the capital gain obtained from selling or renting a regenerated urban property will be subject to a tax rate of 5 per cent, for personal income tax purposes only.

However, it should also be noted that the Law also regulates situations where building work has commenced without the relevant public authority having been given. Where the party carrying out the work does not follow the correct procedures within the deadline set, the local authority may require the owner to pay the fees due.

Finally, it should be noted that this area remains under scrutiny, and further major changes may be expected in the near future.

ABBC law firm is DLA Piper's relationship firm in Portugal.

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Further major changes may be expected in the near future.

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SAFETY LAW IMPLICATIONS IN THE DEVELOPMENT OF INDUSTRIAL FACILITIES IN RUSSIA

IVAN GRITSENKO, MOSCOW

When planning projects to build industrial facilities, the parties involved in the investment process are not always aware that, in most cases, a commissioning permit is a necessary, but not the only, condition before manufacturing can begin.

A commissioning permit, under the Urban Development Code of the Russian Federation, confirms that the completed building corresponds to the design documentation. Furthermore, according to the Law "On the State Registration of Immovable Property Rights and Transactions", the permit is also the basis for the state registration of ownership of a completed capital construction project. As a general rule, the commissioning permit is issued by the local authorities.

However, to operate an industrial facility, it is not only the commissioning permit which is required, but also a number of other permits which are issued based on compliance with relevant sanitary, epidemiological and environmental laws, and the provisions of industrial safety laws issued by the the Federal Service for Surveillance on Consumer Rights Protection and Human Wellbeing (*Rospotrebnadzor*), the Federal Supervisory Natural Resources Management Service (*Rosprirodnadzor*), and the Federal Environmental, Industrial and Nuclear Supervision Service of Russia (*Rostekhnadzor*). These are all federal executive authorities.

Thus, the construction process is overseen by various executive authorities which control the observance not only of provisions of the Urban Development Code, but also some other branches of law regulating production activities.

In this article, we provide a brief overview of the key provisions of the industrial safety laws, which are relevant to the implementation of projects to establish or upgrade industrial manufacturing plants in Russia.

Industrial safety laws

The key regulatory Act in this area is the Federal Law "On Industrial Safety of Industrial Facilities" (referred to in this article as the Industrial Safety Law). It is this law that regulates hazardous industrial facilities (HIFs) and HIF operational requirements. These include, most importantly, the operator's obligation to register the HIF and obtain a permit to operate the HIF. The Industrial Safety Law defines such terms as "technical upgrade" and "industrial safety expert review". These terms are important mainly for the implementation of projects on brownfield sites.

Also of some importance is the Law "On the Mandatory Requirement of Civil Liability of Owners of Hazardous Facilities", whereby the HIF operator is required to have a third party liability insurance contract. Such an agreement is needed not only to obtain the state registration and the permit to operate, but also to obtain a permit to commission a hazardous facility in terms of the Urban Development Code.

Articles 9.1 and 14.1 of the Administrative Offences Code of the Russian Federation (the AO Code) should also be borne in mind. These state that if an HIF is operated without a permit or registration, or if the HIF operator breaches the industrial safety regulations or grossly violates the permit terms, such breaches may result in a fine, as well as the suspension of the undertaking's operations for up to 90 days. In certain cases, the administrative fine for legal entities may be as high as one million roubles. Confiscation of the hazardous facility, raw materials and products is also possible.

In addition to the AO Code provisions, it should also be noted that a breach of the industrial safety laws may result in key management figures in the relevant undertaking being held criminally liable pursuant to Article 171, Part 1 of the Criminal Code of the Russian Federation. Where there are aggravating circumstances, such acts are punishable by a prison term



of up to five years, with or without a fine of up to 80,000 roubles or in the amount of the convicted person's salary or other income for a period of up to half a year.

What is an HIF?

First, it should be noted that equipment itself is not an HIF under the legislation.

A hazardous industrial facility is either the entire enterprise comprising the property complex, or parts of it, such as a workshop or site where:

- explosive, flammable and poisonous substances are handled in the volumes specified in Appendix 1 to the Industrial Safety Law; or
- equipment is employed using steam, gas, water or other liquids at a pressure of more than 0.07 MPa.

Examples of HIFs meeting the above criteria are a paint workshop, various ovens burning gas, or a paints warehouse.

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Although the list of documents required for the state registration of an HIF is exhaustive, in practice, it raises certain issues.

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Another example might be fixed hoisting machines, such as overhead cranes. Lifts, disabled access elevators, and power grid facilities are not HIFs.

Classification of HIFs

HIFs are divided into four hazard classes, class I being the highest hazard and class IV the lowest.

A facility is assigned a hazard class when it is registered in the state register of hazardous industrial facilities. The key criterion for assigning a certain hazard class to a facility is the quantity of hazardous substance(s) located at the facility. Concentrations of hazardous materials serving as a basis for hazard classification of the facility are set out in Appendix 2 to the Industrial Safety Law.

To operate a Hazard Class IV facility, it is only necessary to register the facility in the state register. A classic example of such a

facility is an overhead crane.

To operate Hazard Class I to III facilities, in addition to state registration, a permit is also required.

Key registration and permit requirements for operation of an HIF

It is the HIF operator's responsibility to have the HIF officially registered and to obtain a permit to operate it. An HIF may be operated not only by its owner; but also by a tenant or any other person in legal possession of the HIF.

As a general rule, HIF registration and licensing is handled by the territorial divisions of the Federal Environmental, Industrial and Nuclear Supervision Service of Russia (*Rostekhnadzor*).

After the relevant documents are submitted, *Rostekhnadzor* has 20 business days to issue registration certificates and 45 business days to issue operating permits. Any permit issued is valid indefinitely.

Particular features of HIF state registration

HIF registration is effected in accordance with the special Administrative Regulations of *Rostekhnadzor*. The documents required include: (i) an HIF file; (ii) a third party liability insurance contract; (iii) evidence of ownership or other right of possession of the HIF; and (iv) substantiation of the HIF safety based on a positive assessment by an industrial safety expert.

Although the list of documents required for the state registration of an HIF is exhaustive, in practice, it raises certain issues.

The first question often asked by investors is whether it is possible to have an HIF registered before the building which is to house the HIF is commissioned. If the list is read literally, the answer is to that question is yes. That is, the list of documents does not include a commissioning permit. However, if the text of the list is interpreted on a systemic basis, taking into account all the relevant legislative provisions, it may be concluded that a commissioning permit to put into operation a building in which an HIF is located should be granted on

Rostekhnadzor's requirement.

Rostekhnadzor has the right to suspend the HIF registration, if the HIF operator does not legally own or possess the HIF. As stated above, an HIF is not merely equipment, but also the production site on which certain activities are performed, that is, it comprises both movable and immovable property. Therefore, the applicant must provide evidence not only of ownership of the manufacturing equipment, but also of the building or part of the building where such equipment is located. As the building may only be used for commercial or manufacturing purposes after a commissioning permit is issued, HIF registration is not possible without such a permit.

The second question often asked by investors is whether it is sufficient for the purposes of the HIF registration to provide a preliminary lease agreement in relation to the building or premises as evidence of the right to occupy the HIF. Investors often conclude a preliminary lease agreement in relation to immovable property when the construction of a building or improvements to the premises where the production site will be located are handled by the future landlord, such as the owner of a technology park. The preliminary lease agreement contains the parties' obligation to enter into the principal lease agreement on condition that the landlord constructs a building which meets the tenant's requirements within the agreed timeframe.

The answer to the above question depends on the wording used in the preliminary lease. If it is only about the parties' obligations to enter into the principal agreement for the lease of immovable property upon the satisfaction of certain conditions, for example, if the building is commissioned and the landlord's ownership is registered for lease purposes, such an agreement clearly does not grant the right to occupy and use the HIF, and may not serve as a basis for its state registration.



If the preliminary lease is a mixed contract and grants the HIF operator the right to use the building or part of it before the principal lease agreement is concluded, this preliminary lease should be accepted by *Rostekhnadzor* as evidence of legal possession of the HIF.

This situation can be avoided if a forward lease agreement is concluded. This is permitted by law but in practice, this instrument is used infrequently.

The third question arising in the course of HIF registration is: when is it necessary to submit a safety case?

A safety case is an industrial safety document setting out the risks of accidents at the facility and the conditions under which its operation is safe. This is required in two cases, namely: (i) if the HIF is located in the already existing building (“brownfield”); or (ii) when the existing regulations are not sufficient to safely operate the HIF; or (iii) where such regulations are non-existent.

The safety case must be approved by an industrial safety expert association.

Points relating to HIF operating permits

The requirements that must be met in order to obtain an operating permit for an HIF are largely similar to those of state registration. A person seeking an operating permit is required to submit, among other things, an agreement with a professional rescue association.

Furthermore, the licensing provisions expressly state that, to obtain the permit, the applicant should provide evidence of the right to occupy the immovable property needed to commission and operate the HIF.

Examples of the industrial safety laws influencing the construction process

In conclusion, this section provides several examples of how the provisions of industrial safety laws affect the development of industrial facilities.

At the front-end engineering and design phase, a technical audit must be undertaken to determine how the existing HIFs can influence the implementation of the project being considered. As a rule, the existing HIFs have sanitary and protective zones which may limit or fully prohibit the creation of new industrial facilities. More detailed information on the sanitary and protective zones of HIFs may be found in the HIF files of record and industrial safety declarations.

For the purposes of commissioning a new or upgraded industrial facility, a commissioning permit is issued on the basis of the design documentation. However, as mentioned above, the commissioning permit does not give the right to operate the HIF, and it takes at least 65 days to register and receive a permit to operate the HIF.

Hence the question: is it possible to avoid production downtime during the period between the commissioning date and the date on which the permit is received to operate the HIF? In practice, technical personnel often recommend including a provision in the design documentation to the effect that the facility can be operated in a test mode. In this author’s opinion, this approach reduces but does not completely eliminate the liability for operating an HIF without registration or a

permit, as neither the AO Code, nor the Law “On Licensing of Certain Types of Activities” distinguish between operation and “test mode operation”. It is submitted that the courts and/ or the legislators would do well to address the uncertainty which exists in this area.

There is a commonly held view that the construction of a new building in which manufacturing equipment will be located (a “greenfield” project) takes more time and is more complicated in terms of administration than setting up manufacturing in a brownfield project. This view is based on the assumption that, unlike a greenfield project, a brownfield project does not require the preparation of design documentation, the receipt of a construction permit and the commissioning of the completed project. But this is only true if the industrial site being constructed is not an HIF. In order to be able to register an HIF and obtain a permit to operate it, the investor should lease or otherwise obtain ownership of the building or part of it, prepare a technical upgrade plan and obtain an expert assessment of industrial safety. In complex projects, the time and cost it takes to prepare a technical upgrade plan may be comparable to the efforts needed to produce design documentation. Therefore, from an administrative viewpoint, a brownfield project is not always simpler than a greenfield project.

SUBCONTRACTORS' DIRECT ACTION AND BANKRUPTCY

NATALIA ZUMÁRRAGA, MADRID



The impact of the financial crisis experienced in Spain in the last few years on property sales and construction levels is no secret. In the aftermath of the crisis, even some of the strongest construction companies have faced insolvency, with their fall creating shockwaves throughout the rest of the sector.

The purpose of this article is to examine how a construction company's insolvency may affect other players within a construction project with whom agreements were already in place. As we shall see, there are serious implications for subcontractors, who may lose some of their normal rights and privileges under the Spanish Civil Code in such circumstances.

When a property owner or real estate developer is interested in the construction of a building project, often it hires a general contractor that will be responsible for the overall coordination of the project and will provide the material and services necessary for the construction of the project. The contractual framework of major projects can be complex and the main contractor hires expert subcontractors to perform specific sections of the construction work. No contractual relationship exists between the property owner and the subcontractor. Rather, the contractual relationship is between the main contractor and the subcontractor.

However, when the main contractor breaches the subcontractor's construction agreement and does not pay the agreed fees, article 1597 of the Spanish Civil Code grants the subcontractor a direct action against the property owner in order to

recover the unpaid amounts, up to a maximum amount that is not greater than that owed by the owner of the works to the main contractor. This legal remedy is an exception to the general principle of privity of contracts ("*principio de relatividad de los contratos*") which provides that a contract cannot confer rights or impose obligations arising under it on any person or agent except the parties to it. The exception is based on equitable reasons: namely, the need to avoid an unjust enrichment and to widen the scope of financial responsibility for a third party's debts.

In line with case law from the Supreme Court, this direct action requires the following requirements to be met before a subcontractor can make a claim:

- a) The price of execution of the works shall be certain and determined (or determinable) in the works agreement; and
- b) At the moment the claim is filed, those who work and provide their material and services for the works shall be creditors of the main contractor and the debt shall be due and payable.

Even when these requirements are met, if the main contractor is affected by an insolvency proceeding, the scenario will change substantially, because then the direct action may not be used. Recent precedents from the Supreme Court have determined that the subcontractor is not entitled to bring a direct action against the owner of the works in the event that the main contractor was declared insolvent. This is because the privilege attached to a direct action is inconsistent with other principles of insolvency proceedings under Spanish

law. In particular, it is inconsistent with the *par conditio creditorum* principle, that means that all creditors must, in principle, stand the same chance to collect their debts. The aim of this principle would be frustrated if the income received by the insolvent contractor from the property owner went directly to the subcontractors instead of being paid to the creditors in the order of precedence in which they are established in the insolvency proceedings.

The trend defended by the Supreme Court's case law and the *par conditio creditorum* principle forced the Spanish legislator to amend the Spanish Insolvency Act in 2011, in order to include an express statutory provision on the action provided in article 1597 of the Spanish Civil Code. The prohibition is now regulated by article 53.3 of the Spanish Insolvency Act, which expressly states that subcontractors may not bring a direct action against the property owner during insolvency proceedings concerning the main contractor. Instead they will need to file their claim in the insolvency proceedings and stand in line with the rest of the creditors.

In conclusion, article 1597 entitles subcontractors to claim from the property owner amounts owed by the main contractor. But, given that this privilege is inconsistent with the terms of the Spanish Insolvency Act (the core aim of which is to preserve the principle of equality of creditors), the Spanish Insolvency Act denies subcontractors this right in insolvency situations, as direct action is considered to be contrary to this principle.



BUILDING PERMITS FOR HOMES FOR ASYLUM SEEKERS IN SWEDEN

CHRISTOFER MORALES AND JESSICA LORNE, STOCKHOLM

Introduction and scope

Due to the European migrant crisis, Sweden has seen a great increase in the number of refugees entering its shores. According to the Swedish Migration Agency, over 160,000 applications for asylum were registered in 2015. With an ongoing housing crisis in many of the larger cities in Sweden, the increasing number of asylum seekers has created an urgent demand for housing. In the absence of more permanent housing, asylum seekers have been placed in barracks, schools and gymnasiums. In the southern part of Sweden, asylum seekers were even placed in tents at the end of 2015.

The increased demand for housing for asylum seekers has raised questions of the extent to which building permits must be obtained when homes are built, or existing facilities are altered, for asylum seekers.

The Swedish Migration Agency is the main government body responsible for housing asylum seekers. In order to do this, the Agency runs its own housing stock for this purpose, and also enters into contracts with third parties who provide such homes. Thus, for certain parties, for example, those involved in the hotel and hostel market, the Swedish system has created opportunities for facilities to be used in a new way.

Homes for asylum seekers—characteristics

According to Swedish case law, a home for an asylum seeker is one whose purpose is to offer temporary accommodation to the asylum seeker during the asylum application process. Even though the time of the stay varies, the *intention* must not be to provide permanent residence.

Legal framework

The Swedish Planning and Building Act (PBA) is the main piece of legislation in this area. Under Swedish law, building permits are required when constructing and new buildings. Under the PBA, a building is defined, *inter alia*, as follows:

- of lasting construction;
- with roof, or roof and walls;
- on a permanent location; and
- with the purpose of providing a construction in which people can reside.

It should be noted that these requirements have been widened by case law in recent years. For instance, tents are not deemed to be buildings as they are not of lasting construction nor are they necessarily on a permanent location. However, they may be deemed to be buildings if they are used for a longer period in the same place. It was stated in one case, for example, that if caravans are used for a longer period than a normal camping trip, such caravans may be deemed to be buildings.

Under the PBA, zoning plans distinguish

between buildings for residential purposes and buildings intended for temporary stays. The differences are as follows:

- (i) *residential purposes*, the operation is of a lasting nature, for example, in a single house or a block of apartments;
- (ii) *temporary stay*, provision of accommodation where the operation is lasting although the accommodation is temporary, for example, hotels and hostels.

Should a measure not comply with the zoning plan, it can only be permitted if the applicant is granted a temporary building permit, an amendment of the zoning plan is made or, in certain cases, if the measure deviates only slightly from the zoning plan.

Residential purposes

A property with a building permit for residential purposes may only be used for residential purposes. Using a property zoned for residential purposes for temporary stay, for example, as a home for an asylum seeker, is generally not in compliance with the PBA and such use will not be approved by the local authority building office. Case law has indicated, however, that, for example, a support house where a number of youths aged between 14 and 20 lived was deemed to be used for residential purposes and in compliance with a building permit for residential purposes. The fact that staff worked in the support house did not alter this, as the purpose of the support house was almost identical to residential purposes.



Temporary stay

The category of temporary stay is mainly a definition of the intended type of operation and is not to be interpreted as only including temporary accommodation.

Generally, running a business where people are accommodated is often governed by additional regulations concerning the business. Such regulations may impose requirements on the form and use of the property, managing the business and staff (for example, homes for asylum seekers that also offer care). The use of properties for temporary stay can, under the PBA, affect their surrounding area more than the use of buildings for residential purposes. This may imply requirements of the technical design of the buildings.

In a case from December 2015, a local authority in Sweden was of the opinion that a company's use of a hotel as a home for asylum seekers was an altered use of a building that required a building permit. The local authority stated that the use of the hotel as a home for asylum seekers was not in compliance with the zoning plan, which stated use only for a hotel and restaurant, and ordered the company to cease the operation.

The court held that, even though the length of time asylum seekers are accommodated in a home for asylum seekers varies depending on, for example, the asylum process, the intention is not

to provide permanent accommodation. Thus, the court stated that such homes can be compared to a hotel, hostel or camping area, as regards its form. The fact that asylum seekers may not have their own home and that the stay may therefore be longer than a usual hotel stay, did not affect the judgment.

Thus, the local authority had no legal ground to impose a prohibition on the use of the hotel as a home for asylum seekers as the property had not been used for a purpose significantly different than the hotel business.

Temporary building permits

If a measure is not in compliance with a zoning plan, a temporary building permit may resolve the issue.

In one recent case from the Land and Environment Court of Växjö, a local authority had applied for a temporary building permit to build units for operating a temporary home for asylum seekers. The zoning plan did not allow buildings for residential purposes, but the application was granted with a temporary building permit. The court stated that, in order to receive a temporary building permit it is not sufficient that the measure is merely temporary, for example, using tents that are easily removable. It must be shown that the *need* for such homes is temporary by *inter alia* presenting documentation to show this. The court held that this

requirement had been met.

The case was appealed to the Land and Environment Court of Appeal and judgment was handed down in March 2016. The court came to the same conclusion as the Land and Environmental Court of Växjö, namely, that there were no legal obstacles to the granting of a temporary permit. However, a procedural mistake had been made by the building office and, therefore, the case was referred back to the building office to be rectified and reviewed for a new decision. Thus, the judgment is not yet legally binding.

Summary

It is clear that new building and the use of existing buildings is an area which is undergoing significant changes, as the need for housing has increased rapidly with the European asylum crisis. Many owners of hotels, hostels and camping sites see the provision of homes for asylum seekers as a possible way of filling their rooms during low season. From the case law so far, it seems that the acceptance of new use of buildings may be greater than anticipated. The courts have taken a pragmatic view on the purposes of building permits rather than examining the wording of zoning plans and building permits. However, there has been little case law to date and we can expect further developments in this area in the near future.

CONSTRUCTION METHODS IN TURKEY

TUNAY YILMAZLAR AND SELIN GÜRKAN, ISTANBUL



According to the leading international industry magazine, “ENR Engineering News Record”, with 42 companies among the top 250 contracting companies, Turkey has been ranked again as the country with the second highest number of contractor companies in the world, with huge potential for growth in the real estate sector. Turkey’s construction sector has been at the forefront of the country’s recent economic development.

Over the last decade, the sector has transformed the skyline of Istanbul and other cities, renewed and extended Turkey’s transport infrastructure, and built

new communities and facilities. Already underway is the construction of a third Bosphorus Bridge, further north than the existing two, requiring a new road network as well, with one of these linking to the site of another significant building project, Istanbul’s third airport. Together, these will form the world’s longest combined road and rail bridge. The third airport, meanwhile, is being constructed to the north of the city’s European side. On completion of the fourth phase, in 2025, the airport will have a capacity of 150 million passengers per year, six runways, 1.4m sq. m. of indoor space and four terminal buildings, along with a range of associated facilities.

Major requirements of construction companies in Turkey

Landlords looking to invest in the construction sector will require not only the arrangement of finance, but also approvals from public authorities and close monitoring of the construction activities, all of which necessitates expertise, time and funds. In terms of a contractor being willing to invest in such a project, it may have to reserve most of its available funds to purchase a piece of land, since the purchase of the land itself constitutes a large part of the total investment. Thus, in order to ensure the financial and commercial sustainability of construction projects, the

contractors enter into a construction agreement in return for a share of the land with landlords—the capital, construction and legal work will be carried out by the contractor and the land will be provided by the landlord. On completion, the contractor and landlord share the profit as agreed either in cash or in kind.

What are the types of commonly used construction agreements?

Construction agreements in Turkey are principally subject to the rules and principles laid down by the Supreme Court and the relevant provisions of the Turkish Code of Obligations. In practice, two main types of construction agreements are adopted.

Construction agreement in return for completed flats

On completion of the building project, the land share in return may correspond to independent units, and in this case the agreement is a “construction agreement in return for completed flats”. Under construction agreements in return for land share, the landlord agrees to transfer some of its land shares to the contractor in return for the completion of the construction.

Profit sharing construction agreement

In the second type of construction agreements, called “profit sharing construction agreements”, each party is entitled to a share of the revenue of the completed project to be generated from sale of completed flats to third parties. These agreements are similar to a joint venture, with the landlord investing the property, and the contractor providing the construction works. On completion of the project, each party is entitled to a pre-determined share of the profit achieved on sale of the individual units to third parties.

How do the sharing models differ?

It is clear that the value of the land is crucial in terms of negotiating power of the parties and consequently on the final profit share of both the landlord and the contractor. The ratio of the profit sharing mechanism is decided by the parties themselves. For instance, in the case of highly valuable land, the landowner will seek a higher number of flats from the contractor upon completion of the project, whereas it is the contractor

who will be entitled to more flats in the case of less valuable land.

Key points to consider

First, it is important that the current use of the project land is suitable for the planned project. For instance, in a residential project, the land needs to be suitable for housing. Technical details such as set back distances, maximum heights and construction coefficient of the land must also be in line with the contemplated project. Thus, the current zoning status and any planned changes to that should be borne in mind when drafting the construction contract.

In addition to the above, if the project has further implications for zoning (such as separation of units), this also needs to be provided for in the construction agreement. In most cases, it is the contractor who is responsible for zoning issues. In addition, relevant licensing procedures must be followed as early in the construction process as possible. In short, those involved in a real estate project in Turkey require a high level knowledge of zoning and licensing matters.

Lastly, other agreements, subsequent to the completion of the construction, are becoming increasingly important. For instance, in a mixed used project involving a shopping mall, office tower and a residential complex, a management plan for such project will be essential to determine the common areas to be allocated to each unit individually and the whole project, along with the units' shared expenses. On the other hand, in a real estate project concerning only a shopping mall, lease contracts, operation regulation, and mall and asset management agreements of the shopping mall must be adopted, in line with the needs of the project and current Turkish market practice.

Conclusion

For a real estate project to be completed successfully, it is crucial that the form and content of the construction agreement complies with Turkish law. This will necessitate a carefully drafted agreement between the landlord and the contractor; providing in detail for the matters outlined in this article.

Yüksel Karkın Küçük Attorney Partnership is DLA Piper's relationship firm in Turkey.

“Those involved in a real estate project in Turkey require a high level knowledge of zoning and licensing matters.”

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RISING CONSTRUCTION COSTS

JENNIFER PRICE AND LAURA MOORCROFT, LIVERPOOL

Introduction

Following a rise in prices of 10–13 per cent from the lows of 2010, AECOM's 2015 London Contractors' Survey estimated that construction cost inflation had risen by 10 per cent during 2015, with predicted increases of 7 per cent in 2016. It remains to be seen whether this 7 per cent increase will actually happen but the trend of rising costs is still an issue in the construction sector. This article considers why construction prices are rising and how employers can mitigate these costs.

Why are prices rising?

The prime reason why prices are rising is the lack of supply in the market. Skilled labour has always been the industry's biggest constraint and with demand increasing, this can only continue. Skilled construction workers have found themselves in a strong bargaining position, which is reflected in the rate of wages growth in the construction sector.

Market trends

Although construction input price growth is moderating after two years of strong growth, this moderation is not

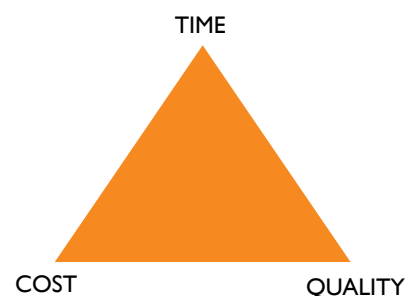
reflected in the growth of tender prices as many contractors are increasing their margins. Contractors are also increasing their tender sums to reflect the risk of insolvency which is still present at all levels of the market.

There has also been a decrease in single-stage tendering; whether the employer is following a negotiated or two-stage process, it is clear that contractors are unwilling to take on all of the risk that they would have done previously. Contractors are also refusing to commit to a price until a later stage and when they do, there is a premium on that price.

The increased demand for skilled labour means that contractors are stretched to their limits. Employers may therefore not be receiving the undivided attention of a contractor's best team. Additionally, contractors are showing an unwillingness to tender. AECOM's report has found that contractors are refusing to submit tenders on up to 50 per cent of projects offered to them, with some of the main contractors only considering 25 per cent of opportunities presented to them. With a potentially weaker team and a price that

is not market tested to the maximum degree, employers can no longer be sure that they are getting the value they were once accustomed to receiving.

The balance of the project management triangle



Received wisdom is that one can only ever manage two of the three parameters at any one time. As construction costs are unlikely to start decreasing any time soon and as increased demand is compromising quality, only one factor of the project management triangle remains properly controllable; time. Further, with costs rising quarter on quarter, it is logical that the quicker the project can commence, the lower the outturn cost of the project will be.



Focus on programme

One way to fast track procurement is by using early works contracts with smaller contractors or remediation specialists ahead of agreeing the final requirements and getting the main contractor on site.

Alternatively, a two-stage process can be used to bring the main contractor on site to do the early works whilst also helping to agree the final requirements. This will involve the contractor and supply chain early in the process.

Furthermore, construction management is becoming more popular as employers are appreciating that it is no longer possible to obtain all of the quality and risk benefits of a design and build contract that were once possible. A construction manager will be paid his fee regardless, meaning he has no interest in growing the project cost and can share the employer's objectives. Further, his experience and assistance can be put to good use from an early point in the project.

Other ways to mitigate the effects of rising construction costs

In addition to fast tracking procurement,

there are other ways in which employers can try to mitigate the effect of rising costs.

Avoid variations

It has already been established that contractors are in a strong bargaining position due to a lack of supply in the market. This position is further strengthened should any mid-project variations arise. Avoiding a late change of mind will avoid payment of inflated and unnecessary extra costs.

Value engineering and shared savings

Value engineering with shared savings may be a way of reducing costs as it provides the contractor with the motivation to seek savings in the works.

Conclusion

With a constrained supply of workers in the market, contractors are able to focus on higher margin work and lower risk projects. As contractors are becoming increasingly selective over which projects they bid for, it is paramount that employers consider how best to balance the need to attract quality contractors whilst also mitigating their costs.

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Avoiding a late change of mind will avoid payment of inflated and unnecessary extra costs.

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SHOULD AN OWNER LIMIT THE ARCHITECT/ ENGINEER'S LIABILITY?

ROBERT CREWDSON, ATLANTA

Many owners and developers may be unaware that most standard form architectural and engineering agreements and proposals promulgated by design firms contain limitations of liability arising out of the architect or engineer's negligence (often contained in the fine print "Terms and Conditions" at the end of the proposals). Some of these are absurdly low—often as low as US\$ 25,000—while others are somewhat more forgiving and can be as high as US\$ 1 million. These limits are generally enforceable in most states, and therefore must be squarely addressed by every owner or developer.

Clearly, the work product of architects, and structural, MEP (mechanical, electrical and plumbing services) and geotechnical engineers (among others) can result in enormous financial loss and damages for an owner if there are errors or omissions in that work product. These damages not only include the repair of defective design (and damage to the building resulting from that defective design), but also damages for delay in completion of a project, or lost rent while defective design issues are being repaired. For larger projects, the losses could be in the millions of dollars.

So what should an owner do? From a practical perspective, most architectural and engineering firms do not have very much capital or the ability to pay a large damages award against them arising out their negligence. The main hope for relief for an owner damaged by errors and omissions lies with the professional



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It is absolutely critical that sufficient insurance limits for the size and complexity of the owner's project are required of every architect or engineer.

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liability insurance carried by the architect or engineer. Therefore, it is absolutely critical that sufficient insurance limits for the size and complexity of the owner's project are required of every architect or engineer. Assuming that sufficient limits of liability are required, one option is to cap the architect or engineer's liability at the amount of professional liability insurance. In that way, the architect or engineer does not face the prospect of coming "out of pocket" for a claim and is likely to agree to a limit of liability tied to their insurance.

It is important to note, however, that unless the professional liability insurance is project specific (and most of the time that is not required), the limits can be eroded by claims on other projects of the architect or engineer. In addition, legal fees to fight a malpractice claim come "off the top" of the limits that are available to pay an owner's damages. Therefore, it may be necessary to engage in a discussion with the architect or engineer as to whether the limit of liability is tied to "available insurance proceeds" or to the limits required in the contract. The latter approach is preferable for owners and developers as it provides an incentive for the design professional to "replenish" its insurance if it has been eroded by other claims, and keeps the design professional's "skin in the game" to the extent of legal fees eroding the policy limits (thus promoting settlement of a claim).

Best Practice: Carefully examine the appropriate limit of liability if one is required by an architect or engineer, and make sure that such limit is reasonable for project size and complexity.

THE IMPORTANCE OF COORDINATING DISPUTE RESOLUTION CLAUSES IN CONSTRUCTION CONTRACTS

ROBERT CREWDSON, ATLANTA

A lot of time is spent by construction owners assessing the type of dispute resolution clauses to include in design and construction contracts. In fact, it is possible to debate for hours whether arbitration or litigation is the best method of dispute resolution, or whether there should be a separate procedure for smaller claims and another for larger claims. This article does not seek to answer those questions, but rather, addresses a more fundamental question that causes unnecessary risk and expense for construction owners—do the dispute resolution clauses in place work together to afford an easy and efficient mechanism for recovery in the event of design and construction claims?

In most cases, construction owners have no idea of the answer to this question. In part, this is because the responsibility for negotiating certain design and construction contracts is often divided among different individuals in the owner's business. In addition, owners often involve outside counsel in the preparation of the construction contract with the general contractor, without involving them in the preparation of other design and construction contracts. As a result, most construction owners do not consciously attempt to make sure their dispute resolution processes with various design and construction contracts work together.

Why is this important? Most construction disputes of any significance involve the participation or liability of multiple parties. For example, damaging settlement in a building after construction might involve the negligence of the geotechnical engineer, the structural

engineer, the architect and the general contractor (not to mention its subcontractors). When faced with the need to make such a claim, the owner might look into each contract with these parties and find the following:

- 1) The geotechnical engineer's contract has litigation as its procedure, but calls for the litigation to occur in a state other than the one in which the project is located.
- 2) The structural engineer's contract calls for arbitration where the project is located.
- 3) The architect's contract calls for litigation, but provides that a trial by jury is waived.
- 4) The construction contract provides for arbitration of claims less than US\$ 1 million and litigation of claims above that amount.

In the example above, the owner has no chance of getting the appropriate and responsible parties in one forum to completely resolve the dispute. That could mean multiple legal proceedings, multiple sets of legal fees and—even worse—inconsistent results where one of the designers is found to be at fault in one forum, and the contractor is found to be the real party at fault in another forum. Simply put, this is an owner's worst dispute resolution nightmare.

Best Practice: Decide on the appropriate dispute resolution procedure for your company and make sure that procedure is reflected throughout the design and construction contracts that are being executed for a particular project.



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Do the dispute resolution clauses in place work together to afford an easy and efficient mechanism for recovery in the event of design and construction claims?

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AUSTRALIA'S FOREIGN INVESTMENT REGIME RELOADED

PETER FALUDI AND BHAVINI SUNDARJEE, SYDNEY



Introduction

Following on from Jane Xu's article, "Changes to FIRB approval of foreign investment in Australian real estate" (Issue 19, 2015, hard copy, page 37; z-mag, page 68), there has been a rapid succession of changes, public consultation and amendments to the legislative and policy regime regulating foreign investment in Australia. In this article, we provide an overview of the following changes:

- the new application fees payable to the Foreign Investment Review Board (FIRB);
- the requirement for approval to

acquire an interest in an "agribusiness" valued over \$55 million and the need to register interests held in agricultural land in a new agricultural land register;

- the civil and criminal penalties applicable for non-compliance with the new regime;
- the increase in the control threshold;
- the revised monetary thresholds applicable to notifiable transactions;
- some changes affecting residential property developers; and
- the imposition of tax compliance obligations as a condition of FIRB approval.

Overview of key amendments to the Act from 1 December 2015

Introduction of application fees

Significant application fees have applied from 1 December 2015 to all foreign investment proposals, with the fee to be paid based on the type and value of the proposed investment. The fee applies per application, the statutory time period only commences once the fee has been paid and if an application falls into a number of categories, the highest fee will apply.

The fees range from \$5000 to \$100,000, with a non-capped fee

applicable to acquisitions of residential real estate.

Requirements in relation to agribusiness and agricultural land

The amendments include a new \$55 million threshold for investments in agribusinesses (except for non-government investors from the United States, New Zealand and Chile, where the limit is \$1,094 million). Agribusiness includes both primary production businesses and first-stage “downstream” manufacturing businesses.

For the acquisition of agricultural land (either directly or through an Australian agricultural land corporation or Australian agricultural land trust), the general and cumulative threshold is \$15 million. However, in the case of non-government investors from the United States, New Zealand and Chile, the threshold is \$1,094 million, and for Singapore and Thailand non-government investors, the threshold is \$50 million (but only where the land is wholly and exclusively used for primary production business).

The \$15 million threshold is based on the total consideration for the acquisition and the total value of all interests in agricultural land already held by the investor. This impacts therefore on foreign investors who already own Australian agricultural land.

Any proposed direct investment by a foreign government in either an agribusiness or agricultural land will require notification to the Treasurer (regardless of the value).

The policy now requires all foreign persons holding an interest in agricultural land, regardless of the value, to register the interest with the Australian Tax Office (ATO). Agricultural land is defined as: “all land in Australia that is used, or could reasonably be used for a primary production business”. The obligation to register with the ATO applies to foreign persons currently holding interests in agricultural land (existing holdings must have been registered by 29 February 2016) and future acquisitions (registration to occur within 30 days of the acquisition).

Penalty regime

Previously, while criminal penalties could be imposed under the Foreign Acquisitions and Takeovers Act 1975,

the high burden of proof (beyond reasonable doubt, rather than balance of probabilities) made prosecutions difficult. As a consequence of the changes, criminal penalties have increased and Australian courts can make civil penalty orders for contraventions of the Act.

The penalties vary depending upon the nature of the breach of the Act as well as the identity of the party who is in breach. The maximum criminal penalty for an individual is \$135,000, or three years’ imprisonment, or both.

In respect of an applicant which is a company, the maximum criminal penalty is \$675,000.

In relation to civil penalties (involving land which is not residential), the maximum civil penalty for an individual is \$45,000 and for a company \$225,000. Generally, the civil penalty for a company is five times that applicable to an individual. For residential land, civil penalties can take the market value or capital gain of the land into consideration.

In addition to the applicants, various third parties and officers of corporate applicants involved in the transaction can also be liable for such penalties in certain circumstances.

Increase in control threshold from 15 to 20 per cent

The “control” threshold for Australian businesses has increased from 15 to 20 per cent (in line with the general takeover threshold under the Corporations Act). This threshold is important as it determines the level of control a single foreign person (including a foreign person that is a corporation) may have in an Australian corporation for that corporation to be considered as being controlled by the foreign person.

There is still an aggregate substantial interest test which provides that where foreign persons hold an aggregate interest of at least 40 per cent in an entity, or hold, in the aggregate, beneficial interests in at least 40 per cent of the income or property of a trust, notification to FIRB will be required.

Relaxation of real estate investment thresholds

Subject to some exceptions, the monetary thresholds for land proposals are as set out in the Table below.

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As a consequence of the changes, criminal penalties have increased.

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Sensitive developed commercial land

Generally, a lower threshold (of \$55 million) will apply to the acquisition of “sensitive” developed commercial land, that is, in circumstances including (but not limited to) the following:

- the land is or will be leased to the Commonwealth, a state or a territory, or a Commonwealth, state or territory body. This may apply even if the area leased to that entity is very small relative to the total lettable area of the building; or
- the land will be fitted out specifically for a business of certain kinds, including the storage of bulk data, the supply of training or human resources to the Australian Defence Force or other defence forces, the manufacture or supply of military goods, equipment or technology to the Australian Defence Force or other defence forces, etc; or
- the land will be under “prescribed airspace”. FIRB has advised that this covers all property under such airspace and is not limited to property within the airspace. This can extend to a large geographic area in capital



cities resulting in the lower threshold applying to a very broad range of transactions.

Significant changes for residential property development

Developers of a residential development seeking a new dwelling exemption certificate will have to pay a fee based on the number of units sold to foreign investors, with an upfront fee of \$25,000 to be paid by the developer on application for the certificate, and a subsequent fee (based on the number of properties sold by the developer within the period) payable every six months thereafter.

The developer will be required to report every six months and make payments in relation to properties sold during that period. In relation to developed lots with a purchase price of \$3 million or more, the exemption certificate will not be sufficient and the actual purchaser of that lot will need to seek their own FIRB approval to the acquisition and pay the appropriate application fee.

Developers (either Australian or foreign) can apply for a new dwelling exemption certificate for a specified development, provided that the development:

- will consist of 50 or more dwellings;
- has development approval from the relevant government authority; and
- if applicable, foreign investment approval was sought to purchase the land and that any conditions of such approval are being met.

The certificate will be granted for a specified development on condition that the dwellings for sale in the development are marketed in Australia.

There is no obligation on developers to obtain a new dwelling exemption certificate however such a certificate does enable the developer to sell the new dwellings to foreign investors without the foreign investors themselves having to obtain separate approval (subject to the \$3 million threshold mentioned above). In the absence of such a certificate, each purchaser would need to obtain its own FIRB approval to the acquisition and pay the appropriate application fee.

Tax compliance to be imposed as part of FIRB approval

On 22 February 2016 the Federal Government announced that it would incorporate a number of tax compliance obligations as conditions of its approval of applications by foreign interests in relation to investment in Australian businesses or real estate.

In a move intended to ensure “companies operating in Australia pay tax on their Australian earnings”, the Government announced a range of standard conditions relating to tax compliance which will need to be met in order for an application to FIRB not to be regarded as being against the national interest.

Failure to comply with these additional conditions could have serious consequences under the provisions of the Act. Indeed, one of these remedies available to the Government in the event of breach is divestment of the relevant property.

The conditions include an obligation on the applicant to pay any outstanding taxation debts, and do its best to ensure that any of its associates pay

any outstanding taxation debts, due at the time of the proposed action. To allow compliance with these conditions, applicants will be required to provide an annual report to FIRB, with the first report to cover the 12-month period commencing on the date of the notice of determination by FIRB. These reports must be provided within 30 days after the end of the relevant 12-month period.

Some consequences

Some of the consequences flowing from the above changes are as follows:

- It will be necessary to ensure that the relevant application fee is paid to FIRB in a timely manner so as to not lead to delays in the processing of applications.
- The broad scope of the sensitive land provisions may result in transactions being subject to a much lower threshold than parties would expect.
- To the extent that an Australian developer or purchaser enters into a joint venture with a foreign person (as defined in the Act) for the purposes of acquiring land in Australia, the joint venture vehicle may itself be treated as a foreign person, resulting in the need for multiple approvals to be sought from FIRB.
- There may be delays in having applications finally resolved within the 30-day statutory timeframe. In order to avoid significant delays, careful consideration should be given to the drafting of sunset clauses in agreements giving counterparties the right to terminate if FIRB approvals are not obtained within the stipulated timeframe.



MONETARY THRESHOLDS

INVESTOR	ACTION	THRESHOLD - MORE THAN:
All investors	Residential land	\$0
Privately owned investors from FTA partner countries that have the higher threshold	Agricultural land	For Chile, New Zealand and United States \$1,094 million* For China, Japan, Korea, \$15 million (cumulative)
	Vacant commercial land	\$0
	Developed commercial land (whether this is sensitive or non-sensitive)	\$1,094 million*
	Mining and production tenements	For Chile, New Zealand and United States, \$1,094 million* Others, \$0
Privately owned investors from non-FTA countries and FTA countries that do not have the higher threshold	Agricultural land	For Singapore and Thailand, where land is used wholly and exclusively for a primary production business \$50 million (otherwise the land is not agricultural land) Others, \$15 million (cumulative)
	Vacant commercial land	\$0
	Developed commercial land	\$252 million
	Mining and production tenements	Low threshold land (sensitive land), \$55 million \$0
Foreign government investors	Any interest in land	\$0

* Note that this does not apply where the acquisition is implemented through a special purpose vehicle into which the investor has invested. In that case lower thresholds will apply.

FOREIGN RESIDENT CGT WITHHOLDING TAX

EDDIE AHN AND CLAIRE KERMOND, SYDNEY

Introduction

From 1 July 2016, a new foreign resident capital gains tax (CGT) withholding tax will apply in Australia. Broadly, under the new CGT withholding tax regime, purchasers of Australian real estate related assets will be required to withhold and remit to the Australian Taxation Office (ATO) 10 per cent of the purchase price where at least one of the vendors is a foreign resident. Importantly, the withholding tax will automatically apply to all sales of Australian real estate related assets unless the vendor provides the purchaser with the required clearance certificate (for direct real estate interests) or declaration (for indirect real estate interests) or, alternatively, if one of the legislative exemptions applies.

Purpose and start date

The purpose of the new CGT withholding tax regime is to assist the ATO in the collection of CGT liabilities of foreign residents. It is designed to address low reporting compliance rates and the consequent high cost of enforcement action against foreign residents in respect of taxable capital gains in Australia.

The new CGT rules apply to sale contracts entered into on or after 1 July 2016. This includes sale contracts that are entered into on or after 1 July 2016 pursuant to an option agreement that was entered into prior to 1 July 2016.

Assets that are subject to the CGT withholding tax regime

The CGT withholding tax will apply to transactions that involve the following types of Australian real estate related assets:

1. taxable Australia real property (TARP), being an interest in Australian real property (including leasehold interests) or mining, quarrying or prospecting rights over resources located in Australia.
2. indirect Australian real property interests (IARPI), being a membership interest in a company or trust that meets both of the following conditions:
 - a. the vendor (together with its associates) holds 10 per cent or more of the total membership interests in the company or trust (or held such an interest throughout a 12-month

- period during the 24 months before the transaction); and
 - b. the majority (ie over 50 per cent) of the assets of the company or trust (by value) consist of TARP assets.
3. an option or right to acquire the above TARP or IARPI assets.

No requirement to withhold—exempt transactions

The CGT withholding tax will not apply to the following types of transactions, which are exempt under the new legislation:

- Transactions involving TARP and company title interests valued below \$2 million;
- Transactions conducted through an approved stock exchange or crossing system;
- An arrangement that is already subject to an existing withholding obligation;
- Securities lending arrangements; and
- Transactions involving vendors who are subject to formal insolvency or bankruptcy proceedings.

No requirement to withhold—clearance certificates and vendor declarations

Broadly speaking, a purchaser will not be required to withhold tax in the following circumstances:

1. for transactions involving TARP or company title interests: the vendor provides a clearance certificate issued by the ATO that verifies that the vendor is an Australian resident for the purposes of the CGT withholding provisions;
2. for transactions involving IARPI or options/rights: the vendor provides a written declaration that confirms the vendor is an Australian resident or that the asset does not constitute IARPI for Australian CGT purposes.

Clearance certificates—TARP or company title interests

The Commissioner may issue a clearance certificate to a vendor, based on information provided by the vendor; that there is nothing to suggest that the vendor is or will be a foreign resident during a specified period. A purchaser will not be required



to withhold under the CGT withholding tax provisions if the vendor provides the purchaser with such a clearance certificate that covers a period including the date the transaction is entered into. A purchaser is entitled to rely on the clearance certificate for the purposes of the CGT withholding tax rules.

The vendor is required to provide the clearance certificate before the time the purchaser is to pay and remit the tax.

The same clearance certificate can be used for multiple transactions for the same vendor that fall within the period covered by the certificate. While the legislation does not provide a specific time period of coverage for a clearance certificate, the ATO has indicated that the clearance certificates will last up to 12 months. The ATO is also currently preparing an online system for the clearance certificate application process.



Vendor declarations—IARPI and options/rights

For transactions involving IARPI or options/rights, the purchaser will be required to withhold unless the vendor makes a declaration in writing to the purchaser that either:

1. the vendor is an Australian resident; or
2. the relevant asset is a membership interest that is not IARPI.

A purchaser may rely on such a declaration unless they have specific knowledge that the declaration is false. A vendor may make a standing declaration that is valid for up to six months after the day it is made. If there are multiple vendors then a declaration will need to be supplied by each vendor.

Such declarations can be requested by the purchaser as part of their due diligence or be included directly into the sale contract; for example, as a vendor warranty.

If the vendor does not provide such

a declaration, the CGT withholding tax will apply, provided that the “knowledge condition” is satisfied; that is, where the purchaser:

1. knows the vendor is a foreign resident; or
2. reasonably believes the vendor is a foreign resident; or
3. does not reasonably believe the vendor is an Australian resident, and either:
 - the vendor has an address outside Australia, or
 - the purchaser is permitted to provide a related financial benefit (for example payment of the purchase price) to a place outside of Australia.

Thus, if there are reasonable grounds to believe that a vendor is an Australian resident then a withholding obligation will not apply on the basis that the “knowledge condition” is not satisfied. Whether there are reasonable grounds to believe a vendor is or is not an Australian resident will be considered on an objective basis. Where a purchaser is uncertain whether or not the “knowledge condition” is satisfied, the purchaser may seek to obtain a vendor declaration, as outlined above.

Rate of withholding and variation applications

Where the CGT withholding tax applies, the purchaser will be required to withhold and remit to the ATO an amount equal to 10 per cent of the total purchase price (being the cost base for the CGT asset). The withholding tax is due for payment by the settlement date. It is expected that payment will need to be made by electronic transfer. Thus, if they have not already done so, purchasers will need to register as a withholder with the ATO before the due date.

In certain circumstances, the vendor, purchaser or a creditor can apply to the ATO to reduce the amount of withholding from the usual 10 per cent rate. The rate can potentially be varied to nil. Examples of circumstances where such applications can be made include where: the vendor will not derive a capital gain from the sale, there are multiple vendors some of which are Australian residents, or if the withholding tax would materially prejudice the creditor’s ability to recover its debt.

Claiming a credit for tax withheld

The CGT withholding tax is not a final tax—the vendor may claim a credit for the tax withheld when filing its tax return for the relevant year. It may claim a refund of tax to the extent the amount withheld exceeds its final tax liability for that year.

Penalties for failure to comply

If a purchaser fails to withhold when required, penalties can be levied up to the amount of the withholding required. Penalties can also apply to vendors that knowingly make false or misleading declarations, recklessly make false or misleading declarations, or do not take reasonable care in making declarations.

Practical issues and considerations

Since all vendors of real estate related assets are assumed to be foreign residents unless appropriate evidence is provided, the CGT withholding tax requirements will need to be considered and appropriately complied with for every sale of real estate related assets in Australia. Thus, parties to such transactions will need to ensure they comply with their respective obligations under the new CGT withholding tax regime, in particular with regards to:

- drafting of contracts in relation to real estate related sale transactions, including sale contracts, property joint venture agreements and property financing documents;
- the timing of applying for and obtaining clearance certificates from the ATO (for example whether on an annual “rolling” basis or on a transaction-by-transaction basis);
- incorporating compliance with the CGT withholding requirements into the settlement process; and
- the vendor and purchaser obtaining the relevant tax registrations to facilitate the payment of the withholding tax on or before the settlement date where required.



DEVELOPING AND LEASING A DATA CENTER

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As technology changes, the demand for data center (DC) space is increasing with many companies needing somewhere to house large banks of data storage. DCs have not always been an attractive investment, in particular due to investors' fear that the need for such storage space will eventually disappear. However, in recent years, the asset class has gained popularity in the private equity and real estate sector:

There are many factors to consider when developing DCs, both from an owner and user perspective, such as the need to consider specific customer specifications and lease agreements, and other legal requirements.

Given the often huge costs of building a DC, it is not surprising that both DC operators and service providers are choosing to lease rather than to build DC spaces. A lease on a DC requires a DC-specific focus, with many of the provisions of the lease agreement being tailor made to the use of the premises and to the tenant's operations within them.

Technical aspects of DCs

The lease agreements on DCs in France are usually subject to in depth technical due diligence and to various condition precedents relating to the obtaining of specific permits in relation to power supply and to location-specific considerations such as proximity to power grids and networks.

Both the tenant and the landlord need to be advised by competent engineering specialists who can help them to evaluate their technical needs. Since the legal aspects of these lease agreements are driven by technical issues, lawyers usually also need the assistance of a project management team to ensure that the contract accurately reflects the agreement of both parties on technical issues and to review technical annexes to the lease which are often as important as the lease agreement itself.

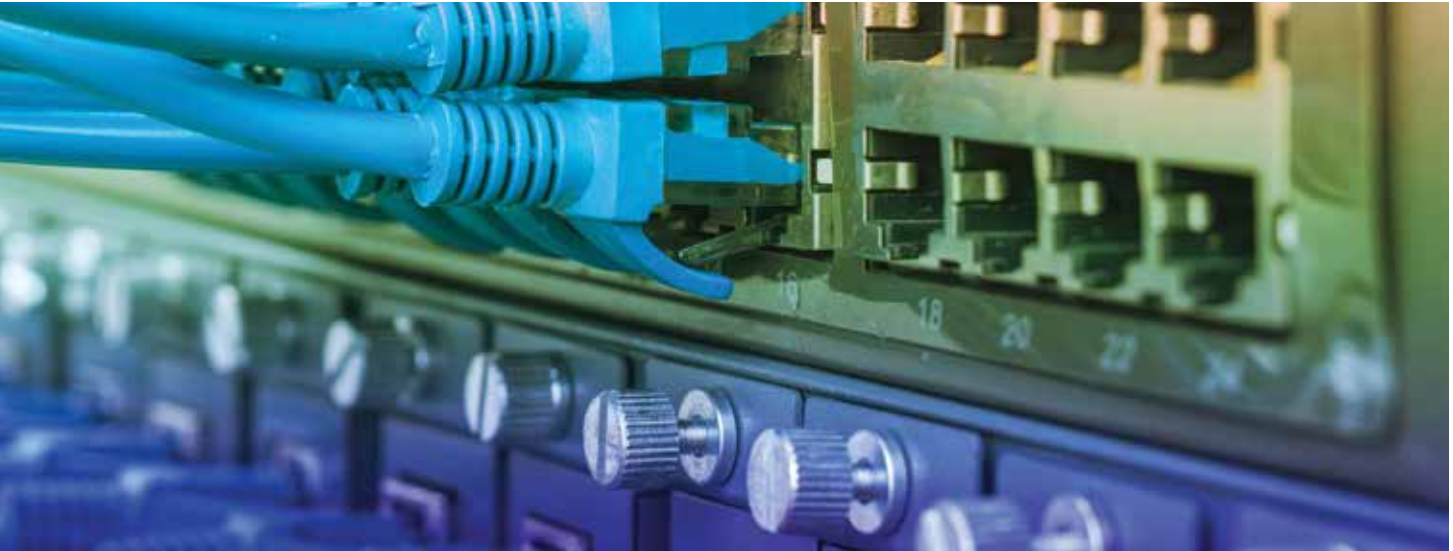
Usually the owner of the DC is responsible only for the shell facilities, with the DC operator being responsible for the configuration of the space and deployment of infrastructure equipment, the cost of which can be higher than the cost of the building itself. In particular, the tenant needs to control the heating, ventilation and air-conditioning system, backup power supplies, and mechanical and electrical infrastructure to ensure a certain level of service to its customer. Because the information stored in the DC can be sensitive, DCs often house very specific security equipment.

DC operators enter into very detailed and specific turnkey contracts for the installation of the equipment which are the heart of their business. Under article 1792 of the French Civil Code, all building contractors are strictly liable to the owner or the purchaser of the building for a period of 10 years after completion for damage which compromises the structural integrity of the works and

renders that building unfit for its intended use. However, the scope of the 10-year contractors' liability excludes liability for equipment such as that installed in a DC. It is for this reason that turnkey contracts for the installation of DC equipment usually include specific contractual guarantees.

Given the high spec design requirements of a DC, the DC operator will be very involved in the technical definition of the property and in the definition of the landlord's works. For leases of property still being constructed, the definition of completion is very complex and can give rise to heated and long discussions between the parties, since any deviation from the original plans can make the building unsuitable for DC use.

Having a new DC ready on time is crucial, in particular where the tenant is migrating a DC from elsewhere or where the tenant is already committed to a fixed date with the end users through services agreements already entered into. Both the lease agreement and the tenant's turnkey contract for the installation of the equipment includes penalties to the benefit of the tenant should the target date not be met by the landlord or by the building contractor. However, any contract subject to French law must take into account the possibility that the amount of the indemnity will be reduced or increased by the court if it is considered to be excessive or ridiculous compared to the real damage suffered.



The tenant is often allowed earlier access to the DC to inspect equipment to be installed before the lease agreement comes into effect. However, it should be noted that this usually raises some issues in relation to the period of co-activity between the landlord and the tenant's work and to the transfer of the legal risk on the premises between owner and tenant.

Longer duration of the lease agreement on DCs

Given the costs involved in developing a tailor made DC for an occupier, the lease agreements on such properties are usually long term. However, in France, the lease agreements are usually entered into for a maximum duration of 12 years, in light of the legal and tax constraints arising from the obligation under French law to publish any lease exceeding 12 years and to pay land registry fees at a rate of 0.715 per cent applied on all the rent and service charges due by the tenant throughout the duration of the lease. The lease agreement usually includes a waiver from the landlord of its right to refuse renewal of the lease, breach of which would give rise to payment of an eviction indemnity to the tenant. This allows the tenant to benefit from an automatic and certain right to renew the lease for at least nine additional years.

Specific provisions to be taken into consideration

The clause which deals with subletting the

premises should be carefully negotiated and drafted, taking into account both the occupier's main business to provide companies with DC storage through service agreements and the landlord's concern to avoid any such disposal being legally classified as a sublease. Indeed, a DC operator will grant permits or services agreements, rather than leases, in the service agreements (which include related services orders) it concludes with its customers. According to French case law, where the principal obligation of such services agreements between DC operators and their customers is the obligation to provide services (and the obligations relating to the use of the premises are secondary by comparison) this may reduce the likelihood of such agreements being classified as subleases (thereby avoiding the specific legal consequences for both the tenant and the landlord which arise from a sublease arrangement). However, if servers and equipment within the DC are separated and secured from other users by cages which have private access, the legal classification of such services agreements could be called into question and may be more likely to be classified as a sublease arrangement.

The lease clearly deviates from general legal rules on accession provided by the French Civil Code and states that all equipment installed by the tenant are owned by the tenant until the tenant's

departure, thus avoiding any transfer of ownership at the end of the initial term of the lease agreement.

The standard provisions of a lease generally require that a tenant must restore the premises to the state they were in at the date they took possession. However, this may be extremely costly for a DC tenant. That is why the reinstatement of the premises upon the tenant's departure is also a provision which is usually discussed at length, the tenant wishing to avoid huge reinstatement costs whereas the landlord is keen to benefit from premises that can be easily leased to a new tenant or with a configuration suitable for typical office or industrial use.

A tenant's requirement to have continuous power, connectivity, access, appropriate security and controlled maintenance and in particular temperatures and humidity, can cause the landlord some concern about potential damages to be paid to the tenant should the latter be unable to operate the DC in some circumstances. A DC owner will therefore attempt to lessen its exposure to liability resulting from any interruption to the tenant's DC operations, leading to detailed and complex indemnification provisions in French lease agreements.

Note: For those interested in DCs generally, the *Real Estate Gazette* (Issue 12, 2013) provided a special feature on DCs, with articles on this topic from Thailand, Belgium, Russia and the UK.

PROPOSALS AIMED AT PROTECTING INDIVIDUAL BORROWERS IN ROMANIA

FLORIN TINEGHE AND FLORINA TOMA,
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Background
Recent difficulties in the repayment of their foreign currency loans due to currency and/or property value risks have prompted several groups of borrowers in Romania to initiate class actions against the banks, debates in the media and even street protests against the National Bank of Romania and the banking industry generally. The basic claim of these borrowers is that they were misled when taking out the loans. They claim that the loan agreements contained several provisions that were highly detrimental to consumers, resulting in the transferral of all the risks associated with the loans, including currency risks, to the borrowers. Against this background, together with the current financial climate in Romania and the fact that 2016 is an election year, the country's law-makers have been showing an increasing interest in reforming the law in this area, in order to better protect individual borrowers.

The initiatives proposed are innovative and, if enacted, will have very serious consequences for the non-performing loans (NPLs) market in Romania. The sale

and enforcement of NPLs already face various challenges under the current legal provisions. The new initiatives will make it more difficult for lenders as it is clear that the Romanian legislature has a strong preference for supporting individual borrowers, rather than the banks. This is in line with trends across the CEE but it is only recently that concrete measures have been initiated in Romania. This article examines the proposed changes and their likely impact on those doing NPL business in Romania.

The proposals

As a starting point, Law No 151/2015 on insolvency procedures for individuals was adopted and was due to come into force on 26 December 2015. The main arguments for adopting a personal insolvency law were (i) the prevailing difficult economic climate in Romania and (ii) the disparity in treatment between Romanian citizens and foreign citizens making use of credit facilities in Romania, as the latter also benefitted from the personal insolvency laws in their country of origin. However, the complexity of the Law and difficulties in formulating rules on how it would work in practice have



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Banks do not have to pursue court action in order to enforce loans and can instead commence enforcement directly through a court bailiff.

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meant that this Law will not now come into force until 31 December 2016.

The law-makers then turned their attention to non-performing loans, particularly the issues of assignment by the banks and conditions set for repayment. Although unable to intervene in specific contracts between the parties, the law-makers were concerned with ways of giving more leverage to individual borrowers when it comes to renegotiating existing loans. The most significant changes in this area are:

- (i) The proposal related to the provision of immovable property for the repayment of a loan.
The proposal was enacted by the President of Romania on 28 April 2016 and became Law No 77/2016. The Law was published in the Official Gazette on the same day and came into force on 13 May 2016.
- (ii) The proposal regarding taxation of income from the assignment of bank receivables. This provided that a tax rate of 85 per cent would be applied to the total revenues recovered through enforcement of portfolios previously sold by banks.

This proposal was rejected by the Chamber of Deputies in December 2015.

- (iii) The proposal regarding the regulation of assigned receivables.
This proposal was adopted by the Senate and is currently scheduled for debate in the Chamber of Deputies. The draft law provides a cap on the amounts obtainable from the enforcement of receivables purchased from the banks. This can be up to double the paid price for the receivable, but not more than the value of the receivable.
- (iv) The proposal to repeal Article 120 of Government Emergency Ordinance No 99/2006 regarding credit institutions and capital adequacy (which provides that credit agreements, including agreements creating personal and/or real collateral, entered into by a credit institution are deemed writs of execution).
Currently, loan agreements entered into by the banks are writs of execution. In other words, banks do not have to pursue court action

in order to enforce loans and can instead commence enforcement directly through a court bailiff. This makes for a simple and cost-effective enforcement procedure for the banks. Consequently, it is claimed that its abolition would make banks more open to negotiation with borrowers rather than making them join a lengthy queue to commence enforcement in court.

This proposal was adopted by the Senate and is currently on the agenda of the Chamber of Deputies' plenum.

The most important of the above is Law No 77/2016 concerning immovable property. We will consider this Law in more detail below.

The giving of immovable property in repayment of the loan

Law No 77/2016 regulates the debtor's right to settle the debt and any ancillary obligations (such as interest, penalties, commissions), arising from a loan agreement in full, through a transfer of the ownership of a real estate asset mortgaged to the creditor.

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The legislative framework governing NPLs is clearly under the spotlight in Romania.

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The Law has received all party support in Romania and was adopted by both chambers of Parliament. However, initially, the Law was not endorsed by the President of Romania, who sent it back for re-examination to the Parliament. The President's main issues with the Law were the ambiguous terminology used and the fact that no consideration had been given to how the Law would operate in tandem with the other relevant pieces of legislation. As a result of the re-examination request, Parliament amended the Law and sent it back to the President for approval. As noted earlier, the President enacted the Law on 28 April 2016 and it came into force on 13 May 2016.

Proponents of the Law argue that its main purpose is to restore the balance in credit agreements by splitting the risk of a decrease in the value of the mortgaged property between the parties.

The Law will apply only to agreements between individuals and credit institutions, non-banking financial institutions and/or to the assignment of receivables held by individuals.

If a debt is secured over two or more properties, the debtor would have to transfer ownership rights over all of the mortgaged assets in order to settle that debt. Following the transfer of those rights, no further obligations would arise under the loan agreement secured by the transferred asset.

Although it is thought the Law will benefit individuals who are unable to pay their debts, the Law does not lay down any conditions regarding the financial status of debtors in order for them to benefit from the provisions of the Law. Therefore, it appears that any debtor, irrespective of their solvency or

otherwise, could at any time benefit from the provisions of this Law.

The express obligations imposed by the Law on the parties include a stipulation that the debtor must notify the creditor, through a court bailiff, a lawyer or a public notary, of its decision to transfer the ownership of the mortgaged asset to settle its debt, and confirm that all conditions provided for by the Law have been met. The creditor is entitled to challenge the debtor's fulfilment of these conditions in court. If the creditor's application is dismissed, it must appear in front of the notary public for the execution of the transfer agreement. If the creditor refuses to do so, the debtor may ask the court to issue a decision acknowledging the settlement of the debt and transferring the ownership of the mortgaged property to the creditor.

When it does come into force, the Law will apply not only to future credit agreements, but also to those in place at the time the Law came into force. This potentially retrospective effect has raised serious questions regarding its constitutionality. Nonetheless, the Law will apply to both existing and future contracts and, in the event of a challenge, it will be for the Constitutional Court to decide.

The legislative framework governing NPLs is clearly under the spotlight in Romania. The developments considered here seem likely to have a considerable impact on the financial sector with all the proposals being indicative of the current trend towards giving individual borrowers more protection. Interested parties would be well-advised to follow the evolution of these legislative proposals in the months to come.



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