Vesting Certificate

Borrower's Guide

Ecology
Building Society

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Contents

1 Introduction

1.1. This Guide explains the purpose and terms of the Vesting Certificate that we (Ecology Building Society) are requiring you to put in place as a condition of your mortgage.

1.2. In this Guide it is assumed that:

1.2.1. you will be entering into a JCT Design and Build 2016 contract (“**the Building Contract**”) with a main contractor (“**the Contractor**”) (although this depends on the extent of the “self-build” undertaken by you); and

1.2.2. either you or, more usually, the Contractor will then enter into a contract (“**the Supply Contract**”) with a factory owner (“**the Manufacturer**”) who will manufacture the modular units or panels (“**the Listed Items**”) off-site in a factory (“**the Factory**”).

1.3. We have used the term “**the Employer**” in the Vesting Certificate to refer to you. This is because under the Building Contract (assuming it is the JCT Design and Build Contract 2016 that you are using) this is the term used to refer to you.

1.4. We have used the term “**Listed Items**” in both this Guide and the Vesting Certificate for the MMC modular units or panels that are to be constructed in the Factory. This also follows the terminology in the JCT Design and Build Contract 2016.

1.5. This Guide is a general explanation of the purpose and terms of the Vesting Certificate. It is not a substitute for taking legal advice and Borrowers should seek their own legal advice on the terms of the Vesting Certificate and its completion and adaptation for their particular circumstances. No responsibility can therefore be accepted by Ecology Building Society or Anthony Collins Solicitors LLP to any individual or organisation in relation to this Guide.

2. Why is a Vesting Certificate needed?

2.1. Most construction works are paid for once they have been completed. However, this is not the case with modern methods of construction” (“**MMC**”). One of the issues with MMC is that the set-up costs for the machinery to fabricate the Listed Items form a significant part of the price for the Listed Items. There is therefore a significant amount of capital investment required, in terms of configuration of the machinery necessary to produce the Listed items. This is why the Manufacturer will want payment up-front for the Listed Items.

2.2. If you are paying for anything in advance you need to consider what would happen if the Manufacture were to become insolvent before you receive what you have paid for (or part paid for). In these circumstances, to complete your new home, you will need to be able to take possession and ownership of Listed Items.

2.3. You will then need to do whatever is necessary to complete the fabrication of those Listed Items so they can be incorporated in your new home.

3. How the Vesting Certificate works

3.1. The Vesting Certificate transfers ownership of the Listed Items from the Manufacturer to the person with the benefit of the Vesting Certificate (here you).

3.2. In order for this transfer of ownership to be effective, there are two additional requirements on top of entry into the Vesting Certificate:

- The Listed Items will need to be readily identifiable in the Factory as being your property, usually by labelling those materials in some way; and

- The Listed Items will need to be separated from other materials in the Factory and not mixed up with them.

3.3. If the Listed Items are not identified as being yours, then there are both practical and legal issues:

3.3.1. Firstly, the materials could be sold by an insolvency practitioner if the Manufacturer becomes insolvent and the insolvency practitioner does not know of the transfer of the materials to you through the Vesting Certificate;

3.3.2. Secondly there is a question over the legal validity of the Vesting Certificate if the materials to which it is subject have not been clearly identified and labelled as being your property. It is possible that in those circumstances the Vesting Certificate would not be effective against an insolvency practitioner or a purchaser from them, although the case law on this is not totally clear.

3.4. Since your contract will usually be with the Contractor and not with the Manufacturer there will be no contract between you and the Manufacturer. Instead your dealings with the Manufacturer will be via the Contractor. It is therefore the Contractor that will need to obtain the Vesting Certificate from the Manufacturer in your favour. This Vesting Certificate will then create the direct contractual relationship between the Manufacturer and you that is necessary to transfer ownership of the Listed Items in you.

3.5. If (unusually) you are contracting directly with the Manufacturer for the supply of the Listed Items then either terms identical to those in the Vesting Certificate could be included into your Supply Contract or you could keep the Vesting Certificate as a separate document (it really doesn't matter which of these options you choose). In these circumstances there will need to be some changes to the terms of the Vesting Certificate, though, since there will not be a Contractor that is a party to it.

4. Explanation of the main provisions of the Vesting Certificate

Overview

4.1. As set out above, the main purpose of the Vesting Certificate is to transfer ownership of the fabricated Listed Items to you. This is achieved by Clause 2 of the Vesting Certificate.

4.2. This is accompanied by warranties given to you by the Manufacturer in Clause 3 that the Listed Items do belong to the Manufacturer (so that the Manufacturer is promising that they can transfer ownership of them to you) and that they have been and will be manufactured in accordance with the Supply Contract.

4.3. Clause 4 sets out the Manufacturer's obligations to label the Listed Items and keep them separate, so that it is always clear that they belong to you.

Inspection rights

4.4. Clause 4 also sets out your rights to inspect the Listed Items in the Factory. It is usual for the beneficiary of a vesting certificate to be given this right to inspect the Listed Items whilst they are being constructed in the Factory.

4.5. As well as checking on the progress of the fabrication process, you or your representative should also check that the Listed Items:

4.5.1. have clearly been labelled as belonging to you; and

4.5.2. have been sufficiently "set aside" by being kept separate from other items being fabricated in the Factory.

4.6. This right to inspect is also given to "anyone authorised by the Employer". In the assigning the benefit of the Vesting Certificate to us you also authorise us and any person appointed by us (e.g. a surveyor) to exercise these inspection rights.

4.7. You or your representative (or we, or our representative) must comply with any reasonable safety precautions the Manufacturer requires when you visit the Factory. The Manufacturer must provide any personal protective equipment (PPE) that it is appropriate for you or your representative to be asked to wear.

Insurance

4.8. The Vesting Certificate requires the Manufacturer to insure the Listed Items in joint names (i.e. both in your name and in the Manufacturer's name).

4.9. You should check that the Manufacturer does this. The Manufacturer must provide evidence of insurance on request.

Intellectual property rights licence

4.10. Clause 6 grants you a licence to use all intellectual property rights that are necessary to complete the fabrication of the Listed Items. This is because the copyright, patents and design rights (as applicable) used in manufacturing the Listed Items will generally belong to the Manufacturer. If the Manufacturer becomes insolvent, these intellectual property rights (along with the other assets of the Manufacturer) will transfer to the insolvency practitioner that is overseeing the insolvency of the Manufacturer.

4.11. There is no need for an outright transfer of those intellectual property rights to you. This would only be needed if you were planning to go into production of the prefabricated units. What is granted, therefore, is a licence that is sufficient for you or, in practice, your Contractor to be able to complete the fabrication of your own Listed Items and to carry out any maintenance that may be needed on them in future.

4.12. Clause 6 also enables you to grant a sub-licence to the new factory/manufacturer and/or contractor engaged by you to complete the build if the Manufacturer and/or Contractor becomes insolvent.

4.13. In addition to having these rights, your Contractor will also need enough knowledge about the fabrication processes of the Listed Items to enable you to have the Listed Items completed (probably by another factory and manufacturer) if the original Manufacturer becomes insolvent or defaults and an insolvency practitioner is not able to sell the Manufacturer's business to another manufacturer who will complete the Listed Items for you. Even if an insolvency practitioner does manage to transfer the Manufacturer's business to a new manufacturer, you will be in a much stronger position in negotiating with that manufacturer if you have both the rights and the information you need to complete the fabrication of the Listed Items without having to rely on them.

4.14. If the Manufacturer remains solvent but defaults under the Supply Contract, the Contractor will need to approach another factory/manufacturer to complete the Listed Items. In these circumstances your Contractor will need both access to the know-how and intellectual property rights to do so.

4.15. Finally, you should ensure that you have sufficient knowledge to have the Listed Items completed if both the Contractor and Manufacturer become insolvent or if the Contractor defaults under the Building Contract.

4.16. This may be a tricky area for you and your advisers to negotiate. The Manufacturer may well regard the knowledge needed to complete the fabrication of the Listed Items as part of their trade secrets. Despite this, you (and through you the Contractor or another manufacturer) will need access to sufficient information to complete the fabrication without the Manufacturer having to give up all their trade secrets.

4.17. One option that you and your legal advisers may wish to consider is using an escrow account. Here the Manufacturer would deposit the necessary information with a third party escrow account holder. The escrow account holder would keep that information confidential whilst the Manufacturer continues to be solvent and meets their obligations under the Supply Contract. However, they would then release this information to you if the Manufacturer becomes insolvent or the Supply Contract is terminated due to the Manufacturer's breach.

Assignment

4.18. You are given the right to assign (transfer) the benefit of the Vesting Certificate, and it is a condition of your mortgage that you do assign the benefit of the Vesting Certificate to us.

4.19. This assignment is effective (in law) when the Notice of Assignment is served on the Manufacturer. This notice should be served in accordance with Clause 14 of the Vesting Certificate.

4.20. Clause 1.2.12 of the Vesting Certificate makes it clear that references to the Employer include the Employer's assignee, so we can also assign the benefit of the Vesting Certificate once the assignment to us has been completed. We would do this if either you repay your mortgage (in which case we would assign the benefit of the Vesting Certificate back to you) or if it becomes necessary to take action to enforce our security.

Termination

4.21. You are given extensive termination rights under the Vesting Certificate, including if joint names insurance ceases to be available for the Listed Items.

4.22. Following termination, the Manufacturer is required to deliver the Listed Items to the site on which you are building your new home or to such other location as you specify. In practice this is unlikely to happen if the Manufacturer is insolvent, so you are given the right to enter the Factory to take possession of them.

4.23. Until the Listed Items are in your possession (or in our possession, if we decide to enforce our security) the Manufacturer's obligations (in terms of labelling, insurance etc.) under the Vesting Certificate continue. However, it should not be assumed that these will be complied with, so you should liaise with us urgently in these circumstances so that either you or we can act promptly to take possession of the Listed Items on termination.

Deed or contract

4.24. Assuming you are engaging a Contractor, there will be no direct contractual link between you and the Manufacturer under the construction documents (other than the collateral warranty referred to below). There will therefore be no mutuality of obligations (technically called "consideration") between you and the Manufacturer that is necessary to make the Vesting Certificate legally valid.

4.25. In some legal documents this is typically overcome by the artificial device of including a nominal £1 payment. However, the same result is achieved by executing the Vesting Certificate as a deed, which is what is required here. However, just in case the Vesting Certificate is not properly executed as a deed, we have also included a nominal £1 payment, to ensure it is valid.

5. Things your building contract needs to include

Building contract

5.1. Whilst the detailed terms of the Building Contract are things your legal advisers need to consider, there are different risks with MMC compared to traditional construction. It is therefore important that your construction documents contain appropriate provisions to manage and assign responsibility for the risks that are specific to MMC.

5.2. You should therefore ensure that your Building Contract and the Supply Contract both deal with the following risks:

5.2.1. **Programme risk**: There will generally be a designated "slot" in the Factory's programme during which the Listed Items for your project will be fabricated. If the site is not ready for those Listed Items due to on-site delays, this will lead to a need to store and insure the Listed Items for longer, adding cost and risk to your construction;

5.2.2. **Measurement and design errors**: The Listed Items will be manufactured off-site to specific dimensions. It will be harder to accommodate inaccuracies in the design and measurement process than with traditional construction methods. This is likely to involve returning the Listed Items to the Factory or having to replace them altogether. A "design for manufacture" mindset needs to be adopted on MMC projects. For this reason it is common to use BIM (Building Information Modelling) to ensure that the design is carried out to a very high standard;

5.2.3. **Quality control**: As with design errors, the presence of defects in the Listed Items can also involve returning the Listed Items to the Factory or having to replace them altogether. It is therefore important for the Supply Contract to require the Manufacturer to have rigorous quality control and checking processes before the Listed Items leave the Factory; and

5.2.4. **Transport risks**: The transport of prefabricated Listed Items will be more complex than the transport of raw materials for traditional construction. The risk of the Listed Items being damaged whilst they are being transported to the Site will therefore be higher than for traditional building materials. The Supply Contract needs to allocate this risk appropriately between the Manufacturer and the Contractor.

Collateral warranties

5.3. As well as the Building Contract including an obligation on the Contractor to arrange for you to be provided with the Vesting Certificate by the Manufacturer, it is standard practice for an employer under a building contract to require the main contractor to secure collateral warranties for them from key subcontractors and consultants, particularly those responsible for design. These collateral warranties are provided to both the employer and the funder.

5.4. These “subcontractor to employer” and “subcontractor to funder” collateral warranties typically include step-in rights under which the employer (you) or the funder (we) can take over the subcontract if either the subcontractor is proposing to terminate it for default by or the insolvency of the Contractor or the Contractor is proposing to terminate it for default by the subcontractor.

5.5. It is therefore important that in addition to the Vesting Certificate, you (as Employer) obtain collateral warranties (with step-in rights) from the Manufacturer in both your favour and our favour. We will also require you to obtain a collateral warranty in our favour from the Contractor.

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