

Insights

HANDS OFF! OWNERSHIP OF GOODS AND MATERIALS ON CONSTRUCTION PROJECTS

Jul 02, 2020

SUMMARY

The future is very uncertain at the moment. There is significant financial uncertainty in the construction industry. With financial uncertainty comes insolvencies, and with that risk comes issues about ownership of goods and materials on site.

As a team we have been asked a number of questions about *retention of title* recently, and answering these questions can be like trying to catch sand.

Scenario

Like most legal questions, we find it easiest to think about the position by reference to a scenario.

Let's take a project with an employer, a contractor and a supplier. The contractor has become insolvent. Before it became insolvent, the contractor was in the process of procuring a specialist air conditioning (HVAC) unit that is intended to be incorporated into the works.

We will consider the position from the perspectives of the employer and the supplier. We have assumed that business to business contracts are in place that contain specific provisions in relation to the title of goods. If there are no such provisions the **Supply of Goods and Services Act 1982** (for construction contracts) and **Sale of Goods Act 1979** (for supply contracts) will apply.

Employer

If the HVAC unit has been delivered and installed on site, then it is "incorporated into the land". It becomes the property of the employer as part of the land that it owns. This is the case whether or not the employer has paid for the HVAC unit.

If the HVAC unit has been incorporated into the land, but the employer has not paid for it, the employer will remain liable to the insolvent contractor for those costs.

If the HVAC unit is sitting on site, but not yet incorporated into the works, the contract terms will be important. Under the **JCT DB 2016**, the contractor (or its insolvency practitioner) is not entitled to remove any such goods from site, even if they have not been paid for (clause 2.21).

JCT DB 2016 also provides that the HVAC unit will become the employer's property once its value has been included in an interim payment and such payment has been made (clause 2.21). It is important that the interim payment identifies with particularity the materials and goods which are the subject of payment, if property is to pass. So a general lump sum valuation will not be sufficient. Parties should also note the decision in **VVB v Optilan** (which concerned a **vesting certificate** rather than the JCT form), where the court held that title to the goods passed to the buyer because the items were included within the "stated values" in the gross certification, even though the net payment certified under the contract's payment mechanism was "nil".

NEC4 ECC (clause 70.2) provides that whatever title the contractor has in the HVAC unit passes to the employer upon delivery to site. Passing of title does not depend upon payment, but it does depend upon the contractor itself having good title.

If the HVAC unit has not yet been delivered to site, the JCT uses the mechanism of "Listed Items" (clauses 2.22 and 4.15). These are particular items which are included in a list attached to the Employer's Requirements. If a Listed Item is included in any interim payment then those items become the employer's property, and the contractor shall not allow them to be moved from the premises where they are stored. The Listed Items must be clearly identified as being held to the employer's order and destined for the works.

Similarly, NEC4 provides that, if the HVAC unit is off-site, whatever title the contractor has, passes to the employer if the supervisor has "marked" it as such (clause 71). The requirements for "marking" will be set out in the Scope.

Mechanisms for transferring title of off-site materials are increasingly important with the growth in modular building. However, in most cases the contractor will not be in possession of the HVAC unit off-site. In reality, the unit will be delivered directly to site by the supplier and therefore the usefulness of the mechanism depends upon the obligations being properly transferred to the supplier through the supply contract.

Supplier

The supplier's contract with the contractor is likely to be a contract for the sale of goods rather than a construction contract, and different considerations apply. Let's assume that the supplier remains unpaid:

- There is a clear tension where the employer has paid the contractor for the HVAC unit, and the supplier has delivered the goods to site but not received payment.

- Most supply contracts contain a “retention of title” clause. Such a clause provides that title in the goods does not pass until payment has been made (whereas the usual position would be that title passes on delivery).
- However, if the HVAC unit has been incorporated into the works, the “retention of title” clause may be ineffective and (unless a charge can be registered) the supplier will rank only as an unsecured creditor in the contractor’s insolvency.
- If the unit has been delivered to site but not incorporated into the works, the retention of title clause may offer some assistance to the supplier. However, the supplier is unlikely to be entitled to enter the site to recover the unit. Doing so may well be trespass.
- The supplier may seek the assistance of the insolvency practitioner to recover the HVAC unit, but **Blue Monkey Gaming Ltd v Hudson** established that the onus is on the supplier to identify its own assets and it is not within the scope of the insolvency practitioner’s responsibilities to do so.
- The employer (having paid for the HVAC unit) will seek to resist any move by the supplier to recover the unit from the site. However, regardless of the vesting provisions in the main contract, if the unit has not been incorporated into the works the employer will not have good title to the HVAC unit if the contractor itself did not have good title. The supplier may have a **claim for conversion**. In this case, the employer and the supplier will need to come to some arrangement in relation to the HVAC unit, which may well involve the employer paying additional sums.
- If the HVAC unit remains at the supplier’s premises, the supplier might be in a better position to retain the unit and may **exercise a right of lien**. However, if the contractor incorporated the “Listed Items” or “marking” (or similar) mechanisms from the main contract into the supply contract, title may have passed to the contractor or employer. Likewise, a vesting certificate may be used to document the transfer of ownership through the supply chain. In reality, a supplier is unlikely to give a vesting certificate or separate and mark the unit on its premises if it has not received payment.
- Where the employer has not paid for the HVAC unit, it should be possible for the employer and supplier to agree direct payment, but the employer should be aware that it may remain liable to the insolvent contractor.

Final thoughts

It is easy to see how whole supply chains can topple over in this type of scenario (and most supply chains are much more complicated than this). Where one party in a supply chain might become insolvent, there are a number of practical steps that other parties involved can take:

- While it might seem counter-intuitive to make payments to contractors or sub-contractors who are facing insolvency, in some situations it may protect the payer's position as regards ownership of valuable plant. However, it is important to be aware whether the payments will flow down to the ultimate supplier.
- Where payment is made, ensure that valuable items of plant/machinery are specifically listed in payment applications and certificates.
- Make full use of any Listed Items or "marking" mechanism (or equivalent), and ensure that it is properly administered.
- Ensure that there is sufficient security at the site, particularly in the event of insolvency of one party.
- Ensure that valuable items are quickly installed in the works.
- The contract between the contractor and the employer may contain specific provisions in relation to materials and plant in the event that the contractor's employment is terminated (and insolvency is often a ground for contractual termination).
- Consider making contractual provision for a **bond in respect of off-site materials** which can be very useful for valuable plant and equipment. JCT makes provision for this already but **NEC4 requires amendment**.
- Contractors and sub-contractors entering into contracts with suppliers need to be especially careful as supply contracts are subject to a different statutory regime. Such parties should be careful to check that their obligations in the supply contract are consistent with their obligations under the relevant construction contract.

This [article](#) first appeared on the Practical Law Construction blog dated 1 July 2020.

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