

IT'S THE LAW: Modular Construction

In September 1620, Captain Christopher Jones set off to take Modern Methods of Construction (and some pilgrims) to the New World. 400 years later Britain is beginning to get the hang of it. In this edition of IT'S THE LAW we look at some of the particular issues you will need to cover in a contract for a modular build.

Britain was an early trailblazer when it came to Modular and Modern Methods of Construction (MMC). The manifest of the Mayflower, as it set sail from Plymouth, referred to the ship's hold containing, amongst other things, the partially constructed walls of a wooden house.

Clear benefits

The benefits of modular, only some of which will have been apparent to Captain Jones and his passengers, are clear and include:

- Highly energy efficient end product: **lower energy bills for occupiers**
- Lower carbon footprint during the development process: **a step closer to zero carbon**
- Better quality assurance from centralised factory production: **homes with less defects and smaller long term maintenance costs**
- Quicker development delivery: **increased capacity of development teams**
- Less disruptive development delivery: **happier neighbours**

Overtaken

It's fair to say that other countries have overtaken us since the 17th Century. British consumers have viewed

modular through the 'prefabricated' prism of post war emergency construction programmes. Our mortgage lenders have been wary. And structural warranty providers have been reluctant.

A critical mass

But things are changing. What has been needed is for modular building in Britain to reach a critical mass. So that consumers begin to perceive it as a high quality end product in their built environment, so that lenders can see that it's not a highly specialised, high risk product and so that warranty providers can gain the experience they need in assessing safety and durability. That critical mass is now, finally, building in Britain.

Getting into the detail

In this edition of ITL we look at some of the issues that need to be considered when agreeing a contract for a modular development. Whilst, to a layperson, the end product may look similar to a traditionally built development, the route to get there is, at a real and practical level, very different. That impacts what needs to go into the contract.

Many forms of MMC

Modular and MMC take many forms. From flat pack



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elements being assembled in situ through to whole, fully kitted out, modules being craned in. Because of this variety, beware of anyone who claims they have a 'standard form MMC contract'. Much depends on the detail and it is important that the contract you sign recognises that.

Having said that, standard forms of contract can be used as a base. JCT, NEC and ICC forms all have elements that can be useful. It's not a case of having to reinvent the wheel each time and much of standard wording in a 'traditional' building contract will still be relevant. But it's important to carefully consider the precise methods of manufacture, delivery and construction being used on a specific project and to ensure that appropriate clauses are drafted or adapted.

Let's get intellectual

In a traditional building contract, the clauses relating to design and intellectual property are often seen as pretty boiler plate. They have evolved over the last century and have pretty much reached a steady state. In reality, there isn't much valuable intellectual property in a brick and much of the building trade's 'knowledge' is in general circulation - so there is no need to go to great lengths in the contract to protect it.

Modular is a whole different ball game. The modular constructor will have sunk millions into designing the modules and they will want that IP to be protected. The employer, on the other hand, will need to be provided with plans, drawings and copyright so that, in future years, they are not beholden to the original constructor when it comes to repairs or alterations. And they will need to be able to pass those across to a purchaser and/or lender if they come to sell or mortgage the completed development.

Negotiations will likely centre on precisely what design work the employer gets copyright to and limitations on what they can use it for and who they can share it with.

An inspector calls

A traditional building contract will include clauses entitling the employer to inspect the site. Clauses may require advance notice to be given and may specify the number of people who can attend. They will likely include wording to ensure that those exercising this contractual right follow health and safety directions, don't give instructions to site workers and don't interfere with the progress of the development.

Those clauses will still be relevant in a modular context. The employer will still want to inspect the works, on site, of incorporating the modules into the development. And, in any event, most modular construction projects will include important on site works – such as groundworks, services and foundations. However, whilst inspection once the modules are being incorporated is important, it is equally important that that is not the first inspection of the modules.

- That's partly because, if a problem is not identified until the first module arrives at the site, you may find that exactly the same problem has been expertly and precisely replicated into the next 30 modules all lined up and waiting for delivery. That's not going to be good for either the constructor or the employer.
- And partly because, in reality, the employer is unlikely to be able to 'open up' to see the inner workings of the module - such as the electrics which sit behind the already installed interior wall.

So the employer is going to want to be able to inspect the modules whilst they are being constructed, and the upshot of that is that the employer needs to be able to inspect the factory. Many of the issues (about notice, health and safety and interference) will be the same.

On a practical level, the employer will need to consider where the factory is. They are not always in this country let alone near. An employer should be pressing for a clause that prevents the constructor from moving the manufacture of the modules to a different location – in case that makes inspection more difficult for them.

There's a whole world out there

If manufacture of the modules will take place abroad, you may find that the constructor in question is constructing units for sites across the globe. It is essential that the specification makes it clear that relevant UK regulations will be complied with.

At a practical level, any employer would be well advised to satisfy themselves that the constructor does have experience of successfully delivering projects in Britain.

Show me the money

Most traditional building contracts work on the basis of some sort of stage or periodic payment mechanism – with the employer paying the contractor 'on the drip'. And with traditional forms of construction there is a logic to that (in addition to the fact that the contractor needs

money). The logic is that, as the works progress, as each brick is laid, the value of the employer's land is increasing.

That gradual incremental increase in value is not seen in the modular model of construction delivery. With modular, you may find that the bulk of the costs are incurred by the constructor before anything actually turns up on site. Whilst, from an employer's perspective, not paying until that point would be nice, it is rarely feasible for the constructor. They will need money to fund their materials and factory costs.

The slightly unhappy modular compromise is to ensure ownership of the modules transfers to the employer whilst they are still at the factory. It's not uncommon for the ownership of the materials being used to transfer even before the module is built. That transfer of ownership is documented by way of vesting certificates. The contract will need to specify when (i.e. what triggers) ownership transfers, what form of vesting certificate is used, who issues that vesting certificate and how to identify what modules/ materials the vesting certificate relates to (usually by way of literally sticking labels on them).

You're busted

There are no easy answers when it comes to insolvency. There never are. But insolvency is particularly tricky when it comes to modular or other forms of offsite construction.

On a construction project using traditional build, the insolvency of the contractor will be a bit of a disaster but not the end of the world for the employer. They will usually have paid out for the work undertaken to date – but, because the employer owns the land, it will usually own that work. The work that has been done to date will be traditional and so the work that will need to be done to finish it off will be traditional. The employer will be able to find another traditional builder (of which there are many) to get it to practical completion and beyond.

Things are much more difficult with modular. Depending on the construction system being used, it will likely not be possible for another contractor simply to take over. The modules are specialist bits of kit that are unique to the original constructor. In theory, the employer may be able to negotiate step in rights to 'step in to the factory' and take over production – but, in reality, that is rarely a possibility at a practical level. There are a number of cases where projects have had to be abandoned part way through, where there has been constructor insolvency. The employer has had no practical option but to clear the site and start from scratch again.

Risks can be mitigated by bonds, guarantees or other forms of default security. It goes without saying that it is critical that employers undertake full financial due diligence and get themselves as comfortable as possible as to the stability of the constructor. This is one of the trickiest issues around modular and it's a risk that needs to be carefully considered in the drafting of the contract.

Trains, ships and automobiles

Particularly if the employer has secured ownership transfer of the modules before they leave the factory, contractual clauses relating to transport are a much bigger deal in a contract for modular construction.

Absent anything else, the risk of damage to something rests with the person who owns it. And the employer just succeeded in negotiating that honour for itself. So, from the employer's perspective, there will need to be clauses clearly shifting that risk back to the constructor. The employer should be seeking clear provisions ensuring that modules are moved as infrequently as possible and moved carefully when they are. Even if damage is a constructor risk, both parties will be concerned to avoid the delay and hassle that it would inevitably bring. And not all damage will be easily apparent. If enclosed pipework is damaged by a module being dropped, the employer may not discover the leak for a number of years. Most employer's will want provisions controlling and giving them notice of the modules being 'on the move' and a right to inspect the transportation process.

Expect the unexpected

As you might expect, the insurance provisions in a contract for modular development will need particular care. There is nothing unusual in that. Additional modular issues to consider will include:

- Insurance of modules during transport (remembering that this may involve international jurisdictions and maritime law if the completed modules are being shipped into Britain).
- Insurance of the factory.
- Insurance of materials and constructed modules whilst at the factory (remembering that this will need to take account of the point at which ownership transfers from constructor to the employer).

Go on, go on ... go on

Above we have tried to give you a flavour of some of the additional things you will need to think through if you are embarking on the modular journey. We have confined ourselves to points that will need to go into the front end of the construction contract. There will be

other differences you will notice when dealing with the design and technical aspects of a modular project, when compared to traditional. We think the benefits of modular construction vastly outweigh the additional work you will need to do to make sure your construction agreement is fit for purpose. Go on, give it a go.

The tiny print

This is one of a series of leaflets published by Devonshires' Real Estate & Projects Department aimed at our property owning and developing clients. No action should be taken on the matters covered by this leaflet without taking specific legal advice.

Find out more

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