

In Practice

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The impact of the assignment to a lender of a building contract

The benefit of a building contract is routinely assigned to lenders in development finance transactions, but a recent High Court case has brought into focus the legal effect of such an assignment and its potential impact on any claim by the assigning developer against the building contractor.

THE CASE

In *Mailbox (Birmingham) Ltd v Galliford Try Construction Ltd* [2017] EWHC 67 (TCC), a dispute arose between Mailbox (Birmingham) Ltd (the Employer) and Galliford Try Construction Ltd (the Contractor) in connection with a construction industry standard form contract (JCT DB2011) entered into by the parties for the refurbishment of a building at Wharfside Street, Birmingham (the Contract). Development finance was provided to the Employer by certain lenders and, as is common, the Employer legally assigned its rights and interest in the Contract to Aareal Bank AG as security agent for the lenders (Aareal). The dispute was referred by the Employer to adjudication, and the adjudicator made an award of damages in favour of the Employer. Either two days before, or on the date of, the referral of the dispute, the Contract was reassigned by Aareal to the Employer. The specific question before the court was whether the adjudicator had had jurisdiction to hear the application from the Employer, and hence whether the damages award should be enforced.

THE LAW

Under section 136 of the Law of Property Act 1925, in order to have an effective absolute assignment of a contract, the following three criteria must be met:

- (1) the assignment must be made in writing by the assignor;
- (2) the assignment must not purport to be by way of security only; and
- (3) express notice in writing must be given to the counterparty.

If this test is satisfied, the assignment has effect in law and the benefit of the contract (including the right to claim damages for any breach of its terms) is transferred to the assignee on the date of notice to the counterparty.

THE ANALYSIS

In any development financing, security is typically granted in favour of the security agent over the main building contract entered into between the borrower (as employer) and the contractor. The security interest granted may be a charge or an assignment, depending on the construction of the alienation clause in the building contract and the terms which are negotiated between the borrower and the lenders at the time. The starting position on assignment in the JCT DB2011 is a prohibition on assignment by the employer or the contractor without the consent of the other (clause 7.1) This is, however, invariably amended to

permit assignments in connection with a financing. In this case it was not disputed that the Contract was capable of assignment and that there was a legal assignment of the Contract to Aareal.

From a lender's point of view, other than the land itself, the building contract is likely to be the most valuable asset of the borrower during the development phase and, in the event of a default by the borrower under its financing, a lender would want to be able to enforce the terms of the building contract, in particular to build out and complete the development.

From a borrower's point of view, it may not be practical or desirable to surrender control of a live contract. The borrower will want to continue to be entitled to deal with the contractor, including in relation to any disputes, and indeed prior to an event of default the lenders may well want this to be the case as well.

The debenture granted by the Employer in this particular case included some curious drafting in the assignment clause, which appears to be an attempt to address this balance of interests. The debenture assigned the relevant contractual rights to Aareal 'provided that each Chargor is entitled until the occurrence of an Event of Default which is continuing to exercise all rights assigned ... and the Security Trustee will reassign any such rights to the extent necessary to enable such Chargor to do so' (Clause 3.3.4).

The court concluded that the wording in Clause 3.3.4 did not make the assignment conditional; rather the court determined that the assignment was unconditional, but Aareal had then granted the Employer permission to exercise the rights prior to an event of default.

Where proceedings are contemplated, the benefit of a contract needs to sit with the right party to avoid arguments about who may issue those proceedings. It is clear from this case that, in the absence of the reassignment by Aareal, the Employer would *not* have been entitled to refer the dispute to adjudication, nor been entitled to any award of damages, as the benefit of the Contract had been assigned to Aareal, even though permission to deal with the contract has been passed back to the Employer. If the right party to pursue a dispute is the borrower, as was the case here (the financing was not in default), it is advisable to liaise with the lenders at an early stage to ensure there is a legal assignment of the relevant contract back to the borrower (including perfection by notice), ahead of making any application. This is particularly important in light of the short statutory time frames which are used for adjudication of construction disputes. If this is not done, there is likely to be a question mark over whether any resolution of the dispute is binding. ■

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