

CLLS CONSTRUCTION COMMITTEE

GUIDANCE FOR CONSTRUCTION LEGAL REPORTING TO THIRD PARTIES

BACKGROUND

1. In recent years, a trend has evolved for parties such as borrowers or owners to procure construction legal reports, undertaken by their own solicitors and addressed to any relevant counterparty. In development finance this is often called borrower reporting and elsewhere this may appropriately be called vendor reporting. This Guidance Note is intended to:
 - (a) promote an informed understanding of the different methods of reporting on construction legal documents;
 - (b) identify relevant issues in connection with construction legal reporting to third parties; and
 - (c) illustrate examples of good practice, when construction legal reporting to third parties is adopted.

Typical Model: Solicitors review and report to their client

2. The most typical model for construction legal due diligence is where:
 - (a) a party that owns or has an interest in a property discloses subsisting construction legal documents to a relevant third party, including funders, purchasers, tenants or other parties, proposing to take an interest in that property; and
 - (b) solicitors for a relevant third party review and report on the construction legal documents to their client, based on a scope and form agreed between them and appropriate for the relevant transaction.
3. This due diligence process typically involves disclosure of relevant construction legal documents together with, where necessary or desirable, relevant enquiries and replies to enquiries. Solicitors acting for any such third party then report to their client, based on the documents disclosed and related due diligence. That construction legal due diligence may then be co-ordinated with technical and commercial due diligence undertaken by others.

Alternative Model: Construction legal reporting to third parties

4. Construction legal reporting to third parties typically relates to real estate investment or development finance transactions, where a counterparty requires due diligence and is to take security over relevant construction legal documents. Rather than a counterparty conducting its own construction legal due diligence, the counterparty agrees to be provided with that due diligence by a report produced by the other party's instructed solicitors. The Guidance Note is primarily relevant to such transactions.
5. A key component of such construction legal reporting to third parties is that the underlying documents are not typically disclosed to the counterparty and/or their solicitors. Instead, the construction legal report to any third party is to summarise the underlying construction legal documents, on the premise that such report will be adequate due diligence for the counterparty.
6. Construction legal reporting to third parties is typically limited to the legal terms of construction legal documents. As such and where necessary or desirable, relevant

enquiries and replies to enquiries in connection with the construction legal documents may be appropriate to be dealt with separately to the construction legal report to any third party. That construction legal due diligence may then be co-ordinated with technical and commercial due diligence undertaken by others.

7. Other relevant circumstances where this reporting model has been adopted include transactions involving:
 - (a) sale or lease of real estate, where the third party will typically require contractual recourse against any party responsible for any design and/or construction of works; and/or
 - (b) sale of any SPV owning real estate as part of a corporate transaction, where the third party will accrue the SPV's rights in respect of any design and/or construction of works.
8. In preparing this Guidance Note, it is recognised that there may be other transactions where the scope of due diligence is agreed to be limited. In those circumstances, appropriate levels of due diligence may be agreed that differentiate from that referred to in this Guidance Note. Accordingly, a preliminary assessment should be made as to the applicability of this Guidance Note to any transaction.

Perceived Advantages and Disadvantages of Construction Legal Reporting to Third Parties

9. In advocating construction legal reporting to third parties, reasons often include the following:
 - (a) the solicitors who produced the construction legal documents are best-placed to report on the construction legal elements of the same;
 - (b) construction legal reporting to third parties will be faster, more efficient and cost-effective; and
 - (c) the co-ordination of due diligence will be more streamlined and effective.
10. In assessing whether or not construction legal reporting to third parties is advantageous:
 - (a) as construction legal reporting to third parties will inherently be summary reporting, complex and/or bespoke construction legal documents are less suited to construction legal reporting to third parties. Addressees of any such report need to be satisfied that this form of reporting is adequate for their due diligence;
 - (b) the quality of the reporting will be a significant factor, on the assumption that the underlying documents will not be disclosed;
 - (c) inadequate reporting may result in increased time, resources and cost in seeking to achieve adequate reporting and/or become a risk issue.

SELECTING CONSTRUCTION LEGAL REPORTING TO THIRD PARTIES

11. Counterparties and their respective instructed solicitors may see benefit in taking the following into account when considering whether to require, accept and/or undertake construction legal reporting to third parties.

Compliance and Risk Assessment

12. Construction legal reports to third parties will necessarily be addressed to any relevant and appropriate third party. Such reports typically also will allow for reliance upon and/or assignment of the benefit of the construction legal report to any third party to be granted in favour of other third parties, for example if a loan involves incoming additional counterparties.
13. Given these arrangements, it may be necessary to consider prior to agreeing to undertake construction legal reporting to third parties whether:
 - (a) any risk, regulatory or other compliance checks are necessary or desirable. This may also need to be periodically reviewed following conclusion of the construction legal report to any third party;
 - (b) such construction legal reporting to third parties may involve different risks, requirements and/or processes; and
 - (c) whether there will be available, to support the construction legal report to any third party, professional indemnity insurance. See also comments below in relation to limitations and caps on liability.

Consideration of these may help to inform scoping, resourcing and costs associated with the proposed construction legal report to any third party.

Terms of Retainer

14. Construction legal reports to third parties may not, without express wording, be subject to the terms of any existing retainer between the solicitors preparing such a report and their client. Further, a counterparty will have separate terms of any existing retainer with their own solicitors, which will not be typically disclosed. It is important then to consider whether any such construction legal report should be subject to:
 - (a) any caps or limitations of liability included in the retainer between the solicitors preparing such a report and their client. Given that the production of such a construction legal report is made under such existing retainer, it is reasonable to presume that such terms should also apply to that report. That presumption will need to be assessed as to adequacy of the retainer in light of the nature and scope of that construction legal report. In these circumstances and if adequate, it is anticipated that extract and/or redacted terms of engagement may need to be disclosed to the counterparty;
 - (b) any further or other caps or limitations of liability; and/or
 - (c) other appropriate scope and/or assumptions in respect of the report.
15. The Committee's view is that any limitation or cap should be agreed by the solicitors producing the report and any addressee on a case by case basis. That should preferably occur before commencing any construction legal reporting to third parties. If not agreed, then that would tend to indicate that construction legal reporting to third parties would not appear to be appropriate. This may then involve:
 - (a) the counterparty procuring its own due diligence;
 - (b) the draft report being progressed by the counterparty's solicitors with the underlying construction legal documents disclosed; and/or

- (c) amendment to any agreed terms anticipating or requiring any such construction legal.

Disclosure of Underlying Documents

- 16. As a key premise of construction legal reporting to third parties is that the underlying construction legal documents are not disclosed, solicitors preparing such a report should consider the potential consequences of reporting in this manner when the underlying documents will not have been disclosed.
- 17. Counterparties should also anticipate whether a construction legal report to any third party, without access to the underlying construction legal documents, will be adequate. If the due diligence requirements of a counterparty may require sight of the construction legal documents, that would indicate that such reporting is not preferred or appropriate.
- 18. There may be circumstances where complex legal provisions are not capable of being adequately summarised. Examples include calculations and/or formula which are not easily replicated or summarised and/or bespoke drafting, the subject matter of which is also inherently complex. In such circumstances, it may be appropriate to append to a construction legal report to any third party relevant extract(s) of the underlying documents. If, however, this becomes a substantive component of the construction legal report to any third party, then that should indicate that such reporting is not appropriate.
- 19. As mentioned above, construction legal due diligence is commonly co-ordinated with technical and commercial due diligence carried out by others. Such other due diligence typically requires sight of the underlying construction legal documents, in whole or in part. How that may be reconciled with non-disclosure of documents for construction legal reporting to third parties is open but such disclosure will regularly occur, independently of the interfaces between solicitors.
- 20. In any event, if disclosure of the underlying documents occurs with solicitors for any counterparty, either inadvertently or otherwise, it may be preferable that there is clarification that the documents received will not be reviewed. This should help clarify whether or not any relevant matters are known to the party receiving the report, outside the scope of the construction legal report to any third party.

Scope of Counterparty's Solicitors' Review

- 21. It is presumed that a construction legal report to any third party will be supplemented by the counterparty's solicitors producing a brief overview report. This process is intended to highlight material issues, if any, referred to or arising from the construction legal report to any third party.
- 22. It is presumed that counterparty's solicitors have no need to be pro-active or intervene in relation to the form and/or content of a draft construction legal report to any third party. The counterparty's solicitors should intend to provide an adequate draft of such a report. It may be necessary or desirable for the counterparty's solicitors to raise discrete points on review and for the solicitors producing the report to clarify and/or re-draft in respect of discrete points reasonably made. Any significant additional work by the counterparty's solicitors outside of that description should not typically be anticipated.

Acceptability of Construction Legal Documentation

- 23. As part of construction legal reporting generally, there may regularly be requests for the solicitors preparing the report to provide a statement, often qualified, as to the acceptability of the construction legal documents referred to in the report. In considering

this issue, on real estate matters the CLLS Certificate of Title (Seventh Edition 2012) includes a certification that, subject to various qualifications and disclosures, the relevant entity has good and marketable title to a relevant property and is solely legally and beneficially entitled to the same. While the concepts of good and marketable title are not relevant to construction legal documents, it may be relevant for there to be a qualitative statement as to the form and substance of construction legal documents reported upon.

24. Recognising that circumstances of any construction legal report to any third party will need to be considered, the following may be relevant:
- (a) Proposed use of the term "institutionally acceptable". This term appears relatively frequently to deserve exploration. In considering that terms, it may be necessary or desirable to consider the following:
 - (i) an uncertain question relates to which institution is being referred to. If, for instance, the party to the construction legal documents has accepted the same, query if that is sufficient for the documents to be institutionally acceptable. Perhaps more likely, both subjective and/or objective issues may need to be considered in determining what is acceptable. The potential for that to create a spectrum of views, opinions and/or conclusions may then be relevant to solicitors producing the report.
 - (ii) timing is relevant as to whether institutional acceptability ought to be determined at the time of the report or at the time construction legal document were entered into. Market norms will evolve over time and economic cycles and so that may have different effects, at different times.
 - (iii) more directly, there may simply be circumstances where acceptability is clearly and objectively in issue. Where that occurs, qualitative reporting ought clearly to respond to the same.
 - (b) It may be relevant whether or not the solicitors producing a construction legal report to any third party had drafted and negotiated the construction legal documents being reported on. That may affect whether or not a qualitative statement as to the form and substance of construction legal documents is affected by this. A potential way of addressing this is for such matters to be disclosed in that report and for adequate reporting to deal with any specific issues. Alternatively, a view may be reached that construction legal reporting to third parties is not appropriate. If that view is reached by reporting solicitors but such reporting is nonetheless required, relevant qualifications may be the preferred way forward.
25. The Committee's view is that any statement, in connection with acceptability of construction legal documents referred to in any such report, should be agreed by the solicitors producing the report and any addressee on a case by case basis.

Matters Connected with Construction Legal Documents

26. Various categories of construction legal documents are dynamic agreements: building contracts for instance will involve the generation of significant amounts of ancillary documentation. Given that, construction legal reporting to third parties is not by its nature capable of adequately reporting if at all, on such ancillary matters.
27. Notwithstanding the above, there may be discrete items that may be capable of being reported on in a summary manner. These include:
- (a) whether any works have achieved practical completion and by what evidence;

- (b) whether any defects liability period has passed and whether obligations to make good defects etc have been fulfilled, and by what evidence;

To the extent that these discrete matters may be reported, by reference to ancillary documentation received, that should be seen as typical scope of construction legal reporting to third parties.

28. There are other matters which are connected with construction legal documents, but which may require enquiries and collation of information. These include:

- (a) if relevant, whether any sums remain payable, due and/or overdue;
- (b) any dispute or difference in connection with any construction legal documents reported upon;
- (c) any known or disclosed defects in design and/or workmanship in connection with any construction legal documents reported upon.

Such matters, while clearly connected to the underlying construction legal documents being reported on, by their nature extend beyond a review of the terms of construction legal documents. Therefore, the nature and extent of that exercise and whether or not the same is appropriate for construction legal reporting to third parties ought to be considered.

29. It will be relevant for the solicitors producing a construction legal report to any third party to consider whether matters connected to the underlying construction legal documents may be included in any such report, or treated as Enquiries and Replies to Enquiries. Factors may include:

- (a) whether the subject matter is capable of being summarised in any such report adequately or, alternatively, whether some other form of disclosure is appropriate;
- (b) the nature and extent of the solicitors producing the report's existing knowledge of such matters and/or the need to undertake investigations into the same; and/or
- (c) the extent and circumstances to which information is provided by or on behalf of others to the solicitors producing the report.

If such matters are to be treated as Enquiries and Replies to Enquiries, then solicitors for respective parties will be familiar with conduct of the same. If such matters are included in any construction legal report to any third party, relevant wording may be appropriate to identify the source, accuracy and responsibility for information provided to the solicitors producing the report.

Adequate Construction legal reporting to third parties

30. To be efficient relative to other models of due diligence, the initial draft construction legal report to any third party needs to be patently adequate. An assessment of the adequacy of such a draft report will need to be undertaken, without verifying the report's contents against the underlying documents. To avoid a review of any draft construction legal report to any third party becoming a significant workstream, such reports should be prepared in a manner that may objectively convey adequacy in such circumstances. Further guidance follows below to promote good practice in adequate reporting.

31. If any draft construction legal report to any third party is reasonably considered to be inadequate, the parties to the transaction will presumably need to agree how to respond to that. This may involve:

- (a) such draft report being amended/uprated;
- (b) the counterparty procuring its own due diligence; and/or
- (c) such draft report being progressed by the counterparty's solicitors with the underlying construction legal documents disclosed.

If other than the first of these, there may also be a requirement to amend or otherwise deal with any underlying loan agreement or other document anticipating or requiring such a report. There may be other options but consideration should be given to mitigating any additional time, resources and cost.

- 32. If inadequate reporting has been provided for an historic transaction affecting the same asset, this should be taken into account in ascertaining whether or not it is appropriate for construction legal reporting to third parties to be adopted for any current transaction and/or for earlier reports to be revised for adequacy.

GUIDANCE AS TO FORM OF CONSTRUCTION LEGAL REPORTING TO THIRD PARTIES

- 33. Construction legal documents in the UK should typically contain a degree of commonality, given the existence of published form building contracts and a degree of custom as to form and substance of construction legal documents generally. This context has allowed for construction legal reporting to third parties to be open for acceptance. So that construction legal reporting to third parties is adequate, the following is proposed as guidance.

Form and Substance

- 34. Each document reported on should be sufficiently summarised, so that the material substance of the provisions of each document may be deduced from the construction legal report to any third party. That should typically involve substantive summaries of the terms of each document. In turn, reporting on substantive provisions should be derived from the form and substance of the same, adequately and in summary form.
- 35. For prospective developments in particular, reporting on key commercial terms should be appropriate. This would be most relevant for building contracts where price, programme and other key commercial provisions assist in understanding the nature and importance of the construction legal documentation. The level of reporting ought not displace other technical and commercial due diligence however.
- 36. Construction legal reporting to third parties should not involve significant reproduction of the underlying documents. This method lends itself to construction legal reporting to third parties not being appropriate, rather it being preferable to simply disclose the underlying documents for the other party's own review and reporting. As noted above, exceptions to this may be where discrete elements of a construction legal document are complex and bespoke, so as to make summarising those discrete elements impracticable. In such circumstances, it may be appropriate to append to any such report the relevant extract(s) of the underlying documents. If, however, this becomes a substantive component of any such report, then that should indicate that construction legal reporting to third parties is not appropriate.

Example reporting:

"Copyright

Subject to the following, the appointment includes an irrevocable, royalty-free, non-exclusive licence to use and to reproduce relevant documents produced by or on

behalf of the Consultant in connection with the Services for any purpose in connection with the Property and/or Project. Further:

- (i) the Consultant waives any moral rights in connection with such documents under the Copyright, Designs and Patents Act 1988;*
- (ii) the Consultant warrants that it has capacity to grant the copyright or has obtained authority to grant such licence; and*
- (iii) the Consultant shall not be liable for the consequences of any use of relevant documents other than the purpose the same were prepared.*

The copyright licence is subject to:

- (iv) payment of all sums properly due under the appointment; and*
- (v) the copyright licence does not include the right to reproduce designs for any extension of the Project."*

37. Good practice should, where appropriate, include relevant opinion or context as an adjunct to summary reporting.

Example reporting:

"The copyright clause included provisos (iv) and (v) above following a process of negotiation with the Consultant was, in the circumstances, accepted by the Employer. Payment of sums properly due will remain for the Employer to perform for the copyright licence to subsist."

Unusual Terms

38. Any provisions that are unusual, atypical or which have ambiguous interpretation should be reported upon in detail.

Example reporting:

"The Building Contract includes a bespoke provision limiting liability to the Contract Sum stated in Article 2. As the Contract Sum stated in Article 2 is capable of adjustment in accordance with the terms of the Building Contract, it is uncertain as to whether the parties' intention was for the limitation of liability to be the sum stated in Article 2 or such sum as may be adjusted."

Parties and Insolvency

39. All entities should be adequately identified, including company registration numbers or equivalent. Any ambiguity in the identity of any entity should be reported on.
40. Any entities known from publicly available records to be insolvent should be described as such. While Companies House provides adequate and regularly updated publicly available information for various UK incorporated or registered entities, other jurisdictions may or may not provide the same, so consideration may be given as to whether further due diligence, in addition to the report, is necessary or desirable.

Assignment

41. Provisions dealing with assignment should adequately report on:

- (a) the terms governing any assignment, novation, charge or otherwise; and

- (b) any relevant provisions that affect the proposed transaction.

Example reporting 1:

"The benefit of the appointment may be assigned or charged twice by the Employer without the consent of the Consultant. We are aware however that the appointment has to date been assigned twice and therefore no further assignments without consent are permitted."

Example reporting 2:

"The Employer may assign or charge the Employer's rights to any party twice and otherwise to any party providing finance to the Employer in connection with the Project and/or the Property, including any re-assignment on redemption of any finance. Given that the construction legal documents are to be charged to the Bank, this provision appears to be adequate to effect the same."

Limitations or Exclusions of Liability

42. It should be a reasonable assumption that any express cap, limitation or exclusion of liability will be adequately reported on in any construction legal report to any third party.

Supplemental Agreements

43. Solicitors preparing a construction legal report to any third party should adequately report on any known or disclosed variation agreements or deeds, side agreements or supplemental agreements in connection with any construction legal documents reported upon.
44. If there are confidentiality provisions relevant to any such other agreements, then an assessment ought to be made as to whether the construction legal report to any third party is permitted, without consent being required, for such disclosure. If, however, confidentiality provisions would restrict construction legal reporting to third parties, then it may be necessary either for:
- (a) consent to disclose such confidential information to be obtained and referred to in the report; or
 - (b) if such consent is not provided, the construction legal report to any third party should adequately report, in compliance with such confidentiality provisions, on the existence of such documents to allow any addressee to consider what appropriate conduct is available in response.

Valid Execution

45. It should be adequate for construction legal reporting to third parties to state whether a document appears to be validly executed. Unless there are known circumstances relevant to valid execution, it would typically be onerous to require further investigation or representations in respect to what appears to be valid execution.
46. Any apparent invalid execution should be stated. This would include where there are missing signatures for either execution and/or witnessing.

Examples of inadequate Reporting

47. Construction legal reporting to third parties is at risk of being inadequate if:
- (a) reporting as to the existence of a clause is in generic terms only.

Example reporting:

"The appointment contains a copyright clause in favour of the Employer.";

- (b) reporting is only in tabular form, without substantive reporting elsewhere in the construction legal report to any third party as to substantive terms.

Example reporting:

<i>Consultant</i>	<i>Skill and Care</i>	<i>PI insurance</i>	<i>Copyright</i>	<i>Assignment</i>	<i>Collateral Warranties</i>
<i>Architect [XYZ Ltd]</i>	✓	£5M	✓	Twice	Funders, purchasers and tenants

Conclusion

48. The Committee will continue to monitor practice in the industry with regards to construction legal reporting to third parties. The Committee would also welcome feedback through relevant channels via the relevant webpage <http://www.citysolicitors.org.uk/cils/committees/construction-law/construction-law-committee-members/>

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