DAMAGE LIMITATION

Q&A Anna Knight and Sarah Quy answer questions about a buyer's position in relation to a property suffering damage between exchange and completion

Question: Which party bears the risk of something happening to a property in the period between exchange and completion?

Answer

This depends on the terms of the sale and purchase agreement. At common law (ie, if the contract is silent on the matter), the buyer takes on the risk of something happening to the property from the moment of exchange. If the contract incorporates the Standard Commercial Property Conditions (2nd ed) (the "conditions") then condition 7 provides for the risk to pass to the buyer on exchange.

Question: Which party should take out buildings insurance in respect of this period?

Answer

This depends on the terms of the sale and purchase agreement. The conditions allow either party to insure. They state that if the seller insures then it must arrange for, or permit, the buyer's interest to be endorsed on the policy and, if a claim is made, on completion of the sale the seller must either hand over any insurance proceeds to the buyer or, if the claim process is still underway, assign to the buyer the right to claim under the policy. The parties might agree that the seller should be responsible for insurance if, for example:

- the contract is conditional on the seller obtaining planning consent for a new development;
- the buyer has weak covenant strength;
- a new building is in the process of being constructed on the property;
- the property is subject to one or more lettings and the seller, as landlord, is required to maintain buildings insurance; or
- the seller is required to maintain insurance under the terms of its finance documents.

If the parties have agreed in the contract that the buyer will insure then the seller is not obliged to maintain its insurance during this period. In practice, buyers tend to insure the property just prior to exchange. Often the seller will also keep the property insured (in case the buyer fails to complete), which means that there will be two insurance policies in force for this period. This is not a problem if the policies insure separate interests, ie neither party has any rights under the other party's policy.

"Double insurance", by contrast, is where one person has more than one insurance policy in respect of the same risk on the same property. For instance, if the buyer takes out its own policy on exchange but is also covered by the seller's policy under a general provision for "intending purchasers".

The insured cannot recover twice, so the issue is which insurer bears the loss. If the policies are silent on this matter then the equitable doctrine of contribution applies and whichever insurer pays out can seek a contribution from the other.

Most insurance policies, however, do contain terms to regulate this and either exclude or restrict cover. As a rule of thumb:

- where both policies contain a rateable proportion clause, those clauses will both apply and each insurer will be liable only for its proportion of the insured's loss;
- where both policies exclude payment in this situation then these restrictions are deemed to cancel each other out and the contribution requirement will apply; but
- where only one policy contains such restrictions then these are more likely to be enforceable. For instance, in *National Farmers Union Mutual Insurance Society Ltd* v *HSBC Insurance (UK) Ltd* [2010] EWHC 773 (Comm); [2010] PLSCS 111 where a property was damaged between exchange and completion and both parties had effected insurance, only the seller's policy excluded payment if the buildings were insured under another policy, so the buyer's insurer had to pay the whole amount of the claim.

Question: Who is responsible for maintaining and repairing a property during the period between exchange and completion?

Answer

On exchange of contracts the beneficial interest in the property passes to the buyer, although the seller remains the legal owner. The seller is therefore holding the legal estate on trust for the buyer and has various trustee duties towards the buyer, including a duty to manage and preserve the property. While this duty might not run to decoration, it means that the seller must not wilfully damage the property and must take reasonable care of it.

Question: What happens if the property is damaged during this period to such an extent that the buyer no longer wants to complete the purchase?

Answer

Unless the buyer has managed to negotiate a specific provision in the contract, it will be obliged to complete even if the property is damaged. Under the terms of the conditions (and under the general law), there is no right to rescission in these circumstances. The buyer must proceed to completion and must pay the full purchase price. If it has insured, it may claim through its insurer for the cost of repairs or reinstatement but:

- the insurance proceeds may be reduced because of the seller's insurance: condition 7.1.4 says that if the contract provides for the buyer to maintain insurance but the seller has also effected insurance and the buyer's insurance payout is reduced as a result, then the amount of the reduction is to be deducted from the purchase price; and/or
- if the seller has caused/permitted the damage, in which case the buyer can consider bringing a claim for damages against the seller for breach of its duty of care as trustee, then the insurance proceeds may be reduced proportionately by any damages awarded.

If the buyer refuses to proceed with the purchase then the seller can serve a notice to complete, following which it will be able to rescind the contract, forfeit the deposit, and claim damages or specific performance.

The contract would be deemed to be terminated by frustration only if the damage was so extreme that the land itself did not exist, for instance as a result of landslip or flood damage. Frustration would not apply where the property had been burnt down or blown up.

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