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It's All Over Now: Practical Completion and Defects

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Mears Ltd v Costplan Services (South East) Ltd & Ors [2019] EWCA Civ 502 is a recent decision of the Court of Appeal. In that case a prospective landlord agreed to construct two buildings (student accommodation blocks) on its land in accordance with a certain specification. A prospective tenant agreed it would take a 21 year lease of the buildings if “*practical completion*” was achieved before a certain date. The landlord’s contractor proceeded to construct blocks in which some 55 or 56 rooms which were all at least 3% smaller than had been specified. The landlord maintained that the work was, nonetheless, “*practically complete*”, and so that the tenant was obligated to enter into the lease.

The case provides some guidance on the meaning of the term “*practical completion*” (which plays an important role in the JCT standard form building contracts). Discussions of the case have focused on that aspect.

Mears is arguably also interesting, however, as part of wider discussion about whether English law (or those applying it) tend to treat contractors who build defective buildings rather more generously than manufacturers and sellers of defective goods, and whether that distinction is always justified.

Goods not as Described – Commercial Contracts

The Sale of Goods Act 1979 (“**SOGA 1979**”) implies certain terms into commercial (i.e. business-to-business) “*contracts of sale of goods*” including that “*where there is a contract for the sale of goods by description, there is an implied term that the goods will correspond with the description*” (section 13(1)).

That implied term is, by default, a “*condition*” (section 13(2), though this can be negated or varied (section 55). At common law, “*condition*” denotes a term which is so important that, if it is breached, the innocent party will be entitled to terminate the contract and reject the goods.

That position is modified slightly with respect to the condition in section 13(1) by section 15A(1) which says: “[w]here ... the buyer would, apart from this subsection, have the right to reject goods by reason of a breach on the part of the seller of a term implied by section 13 ... but the breach is so slight that it would be unreasonable for him to reject them ... the breach is not to be treated as a breach of condition but may be treated as a breach of warranty”. The seller has the burden of proving that a breach falls within section 15A(1).

Section 13(1) applies unless a contrary intention appears in, or is to be implied from, the contract. Hence it is always open to the parties to agree that the implied term does not apply, or is not a condition, or is to have a different effect. It is common for parties to exclude (or tribunals to construe contracts as excluding) the section 13 implied term and the attendant right to terminate / reject goods if they do not comply with the description in the contract. See *Star Polaris LLC -v-HHIC-Phil Inc* [2016] EWHC 2941 (Comm) and *Air Transworld Ltd v Bombardier Inc* [2012] EWHC 243 (Comm) for examples.

Nonetheless the default position is that section 13(1) does apply, and even complex, high value goods are regularly ordered, manufactured, bought and sold under much sparser contracts which do not modify that default position.

Goods not as Described – Consumer Contracts

The Consumer Rights Act 2015 (“CRA 2015”) provides for a different position to apply when a consumer (“an individual acting for purposes wholly or mainly outside the individual’s trade, business, craft or professions”) enters into a contract with a trader. Every such “contract to supply goods by description is to be treated as including a term that the goods will match the description” (section 11(1)). If a trader breaches that term the consumer has various rights, the most relevant being “the short term right of rejection” – a right to reject the goods and treat the contract as at an end within a certain time limit (essentially 30 days from delivery) and to receive a refund of anything paid or, alternatively, claim damages (sections 19, 20 and 22).

It should not be assumed that all consumer contracts for the sale of goods will be low value. High net worth individuals regularly enter into substantial contracts to purchase (for example) luxury vehicles, yachts, art, antiques or similar items for their personal use. There is no upper limit on the value of contracts to which CRA 2015 applies.

Work to Land not as Described

An ‘entire’ contract is one where entire performance by one party is a condition precedent to the liability of the other party. For example, A and B agree that B will run a marathon and A will pay B £10 if B completes it. That would probably be held to be an entire contract - if B gives up at (say) 13.11 miles (halfway) B is not entitled to be paid £5 – B gets nothing.

It is a question of construction whether a contract is entire – i.e. did the parties intend that the contractor would have no entitlement to payment if the work was not completed?

In *Sumpter v Hedges* [1898] 1 QB 673 Sumpter agreed to build two houses and some stables on Hedges’ land for a lump sum. Sumpter abandoned the contract with the work unfinished. Hedges finished the work, so had the benefit of Sumpter’s work. The Court of Appeal held Hedges not to be entitled to any payment for his work, however: “where there is a contract to do work for a lump sum, until the work is completed the price of it cannot be recovered”. “[T]he defendant found his land with unfinished buildings upon it, and he thereupon completed the work. That is no evidence from which the inference can be drawn that he entered into a fresh contract to pay for the work done by the plaintiff”.

Sometimes it is obvious that parties did not intend a contract to be entire. For example, a contract which provides for payment in instalments is not an entire contract so far as those instalments are concerned, though it may be entire with respect to any intention – the Contractor must complete all of the work before any retention is payable.

The contractor’s position is also ameliorated by the principle of “substantial performance” identified in *Hoenig v Isaacs* [1952] EWCA Civ 6:

“the ... question is whether, on the true construction of the contract, entire performance was a condition precedent to payment. It was a lump sum contract, but that does not mean that entire performance was a condition precedent to payment.”

“When a contract provides for a specific sum to be paid on completion of specified work, the Courts lean against a construction of the contract which would deprive the contractor of any payment at all simply because there are some defects or omissions. The promise to complete the work is therefore construed

as a term of the contract, but not as a condition. It is not every breach of that term which absolves the employer from his promise to pay the price, but only a breach which goes to the root of the contract, such as an abandonment of the work when it is only half done. Unless the breach does go to the root of the matter, the employer cannot resist payment of the price. He must pay it and bring a cross-claim for the defects and omissions, or alternatively set them up in diminution of the price. The measure is the amount which the work is worth less by reason of the defects and omissions ..."

The authors of *Keating on Construction Contracts* suggest that "words at least as strong as "complete in every particular" relating to the payment provisions would be needed to exclude the principle".

Work to Land not as Described: An Illustration

Ruxley Electronics & Construction Limited v Forsyth [1996] 1 AC 344 is a well-known decision of the House of Lords.

In 1986 Stephen Forsyth retained Ruxley, a builder, to build a swimming pool of a certain size next to his house near Cranbrook in Kent, England. The builder built a smaller pool instead. From the judgments it is not possible to say precisely how much smaller the pool was, in percentage terms, than the pool which had been ordered because the pool had a sloping bottom, and the length of the pool is not stated. At a particular point, though, the pool should have been 7ft 6in (228.6cm) deep, but was only 6ft (182.88cm) deep. So, at that point, the pool was some 20% shallower than the contract had specified. This caused no practical difficulty, because even a 5ft pool is safe to dive into, but it was not what Forsyth had ordered.

Forsyth argued that the contract was an entire contract. The pool had never been completed. Therefore, he owed the builder nothing. The judge at first instance found the contract was not an entire contract and the pool was substantially complete. Failing to build the pool to the correct size was only a breach of warranty, not a failure to meet a condition precedent to payment. The contractor was entitled to be paid the contract price. Forsyth's claim was only to damages. That finding was not appealed.

What damages was Forsyth entitled to, at law? Forsyth did not want the smaller pool – he wanted what he had ordered. He claimed around £21,000, for the cost of demolishing the smaller pool and building the bigger one he had ordered. He gave an undertaking that, if awarded what he claimed, he would in fact carry out the work.

Forsyth was told it would be "*absurd*" and "*unreasonable*" to demolish the small pool and construct in its place the larger pool which had been specified in the contract. Therefore, rather than award him the cost of fixing the defective work, Mr. Forsyth was instead awarded only £2,500 to represent his "*loss of pleasure and amenity*". That was reversed by (a majority of) the Court of Appeal, who awarded Mr. Forsyth the £21,000 claimed. The House of Lords reversed that, reinstating the £2,500 award.

Work to Goods not as Described in a Consumer Contract: An Illustration

Suppose that, instead, Forsyth had placed an order with Ruxley, a yacht manufacturer, for a yacht for Forsyth's own personal use, to feature a swimming pool of the same dimensions. Ruxley constructed a yacht with a pool which is 20% smaller than the contract requires. Pursuant to CRA 2015 Mr. Forsyth would be entitled to reject the yacht and treat the contract as at an end. If Forsyth had paid any part of the contract price for the yacht, he could insist upon a refund.

Alternatively, Forsyth could claim damages. He orders a substitute yacht from another manufacturer, for a higher price. He claims damages to put him in the position he would have been in if the contract had been performed and a compliant yacht had been delivered: the cost of procuring a compliant yacht, plus damages to represent his loss of amenity by reason of his receiving that compliant yacht later than if Ruxley had performed its contract.

What Justifies the Differing Treatment of Defective Work to Land and Defective Goods in Consumer Contracts?

The distinction is between the two scenarios, and why they fall to be treated differently, appears obvious. It is that the pool has been incorporated into Ruxley's land whereas the yacht is moveable.

- Suppose one were to hold that the swimming pool contract was an entire contract, with even the principle of substantial completion excluded. Forsyth need pay nothing because the pool is not complete in every respect. Because the pool is incorporated into Forsyth's land, however, Forsyth would enjoy a windfall. Just as Hedges got the part completed buildings for nothing, so Forsyth would get a (non-compliant) pool for nothing.
- In order to obtain, instead, the compliant pool Forsyth ordered it would necessary to demolish the non-compliant swimming pool. Ruxley's work is entirely wasted. With the yacht, on the other hand, one does not have to scupper the non-compliant yacht in order for Forsyth to obtain a compliant substitute. Forsyth rejects the yacht, so never receives any benefit, and so the question of whether Forsyth should give credit for that benefit never arises. Equally Ruxley's work does not go to waste – Ruxley has the non-compliant yacht which Forsyth has rejected, and can sell it to someone else to offset its liability to Forsyth.

From the buyer's perspective, however, the description of what was to be delivered in the yacht case and in the pool case are superficially similar (the description of the swimming pools might in each case be in absolutely identical terms "*a 7.5ft deep swimming pool*"). But in one case the law seems to give those words much greater force:

- Order a yacht with a swimming pool and parliament (by CRA 2015) says you can insist upon exactly what you had specified (or at least a full refund).
- Order a swimming pool installed in your garden and it is open to the contractor to install something different, because the courts will construe that contract not to be entire / to be subject to the doctrine of substantial performance. Hence, if you contract for a 7ft or 8ft or 9ft deep pool, be aware that the contractor can always save himself some excavation and construction costs by building a 5ft deep pool instead (because that is safe for diving), insist upon being paid the whole contract price (because the contract is not entire and/or 5ft is substantial performance) less (say) £2,500 1986-pounds for the associated "*loss of pleasure or amenity*" (£7,196 in 2018-pounds, according to the Bank of England inflation calculator).

Can Parties Contract out of Ruxley?

An issue which has not been considered directly in the case law is whether parties can exclude *Ruxley* by agreement.

Suppose parties were to agree something like the following:

“In the event that the Work is not exactly in accordance with the Employer’s Requirements in every particular and/or is not entirely free of defects or omissions, however minor or inconsequential, the Contractor shall pay to the Employer an amount (to be determined if not agreed) equal to whatever would be the cost of rectifying or re-performing the Work to render the Work exactly in accordance with the Employer’s Requirements in every particular and entirely free from defects or omissions, however minor or inconsequential.”

In the event that the work was then completed with some minor defect, which it would be absurd and unreasonable to rectify, a contractor’s response to such a clause might be to argue that it is unenforceable because it offends against the penalty rule.

The penalty rule precludes agreements which prescribe a remedy for a breach of contract which is exorbitant or unconscionable compared to the innocent party’s interest in the contract being performed (*Cavendish Square Holding BV v Talal El Makdessi* [2015] UKSC 67). Prior to that case the test had (essentially) been whether the agreed remedy was a genuine pre-estimate of the loss which the breach would cause, and the judgments in *Cavendish* identify a residual role for that test which it is said will “usually be perfectly adequate to determine [a clause’s] validity” (Lords Neuberger and Sumption at paragraph 32).

A contractor would argue that the House of Lords (in *Ruxley*) has determined that the employer’s loss in such a scenario is not the cost of rectification, but only the loss of value or amenity. The costs of rectification are thus not a genuine pre-estimate of the loss which the breach will cause, and such an agreement is void as being contrary to the penalty rule.

If that is correct (there is no authority on the point) it sits uneasily with the fact that contracts for work to land can be made entire, and the principle of substantial performance can be excluded by agreement, the effect being to largely circumvent the controls imposed by *Ruxley*. Suppose that the same contract as posited above had also provided:

“The Contractor shall have no entitlement to be paid any part of the Contract Price until such time as the Work is completed exactly in accordance with the Employer’s Requirements in every particular and is entirely free of defects or omissions, however minor or inconsequential.”

“The Employer shall be entitled to terminate the Contract (in its absolute discretion, for any reason or none) at any time after the Completion Date if, on the Completion Date, the Work is not completed exactly in accordance with the Employer’s Requirements in every particular and entirely free of defects or omissions, however minor or inconsequential.”

There is no reason to think such clauses would not be given effect. If the Work contained unrectified defects on the Completion Date then the employer could terminate the Contract and (as in *Sumpter*) retain all the benefits of the contractor’s work while having no liability to pay the contractor anything.

Contractors would, of course, be well advised to resist agreeing to such terms, but it is hardly beyond the realms of possibility that there might be instances (say, in cases involving wealthy, sophisticated consumers who are dealing with unsophisticated, inattentive, overconfident or desperate contractors) where a contractor would agree to something like this. The result would, in all likelihood, be a very interesting case.

Are Defective Work and Defective Goods also Treated Differently in Commercial Contracts?

Suppose Forsyth ordered the yacht not for his personal use but exclusively for use in his business. The contract would then be governed by SOGA 1979 rather than CRA 2015. By making the pool on the yacht 20% smaller than had been specified in the contract, Ruxley would breach the condition implied by section 13(1) of SOGA 1979.

But it would be necessary to ask whether Ruxley's breach in making a yacht with a 20% smaller pool was "*so slight that it would be unreasonable for [Forsyth] to reject*" under section 15A of SOGA 1979.

If so, Forsyth would only be entitled to claim damages, not to reject the yacht. The *Ruxley* principle would then apply to that claim for damages. If it was unreasonable to rectify the defect then Forsyth could not recover damages based on the cost of rectification. If the smaller pool did not reduce the value of the yacht, and did not make it any less profitable, Forsyth might recover only nominal damages.

Is the effect of section 15A thus functionally equivalent to the presumption against entire contracts / doctrine of specific performance such that, in the commercial context, defective goods and defective work to land are treated essentially the same?

- **Section 15A.** The default position, absent contrary agreement, is that the buyer cannot reject the goods if the non-conformance is "*so slight that it would be unreasonable ... to reject*".
- **Presumption against entire contracts / doctrine of substantial performance.** The court will "*lean against a construction of the contract*" which entitles the employer to terminate for a breach which does not "*go to the root of the contract*" (such as completing the work but with "*some defects or omissions*") as distinct from a breach which does "*go to the root of the contract*" (such as "*abandonment of the work when it is only half done*").

The answer to whether 15A means defective goods and defective work to land are treated equivalently thus depends upon whether it is possible for goods to fail to correspond with their description in a way which:

- does not "*go to the root of the contract*"; but
- is also not "*so slight that it would be unreasonable to reject the goods.*"

In such case a buyer would be entitled to reject the goods, but if an equivalent defect was present in building work, the employer's only remedy would be a claim in damages.

The meaning of "*the breach is so slight that it would be unreasonable to reject*" in Section 15A seems to have been considered rarely. There are two first instance cases on LexisNexis:

- *Filobake Ltd v Rondo Ltd and another* [2004] EWHC 695 (TCC). An industrial oven was supplied with a defective belt tensioning device which caused a conveyor belt to fray. The buyer sought to reject the oven. This minor defect was a breach of the implied term in section 14 of SOGA 1979 that goods are of satisfactory quality and fit for all the purposes for which goods of the kind in question are commonly supplied. Like the section 13(1) term, that implied term is a condition, but subject to control in section 15A. It was held that the "*breach was so slight ... that it would have been unreasonable, ... to reject the Oven*". No further reasoning is given, but the court appears to have arrived at that view at least in part

because of evidence to the effect that the device “*could easily have been replaced*” and the defect did not prevent the oven being operated and pastry being made – it only meant that doing so would cause the belt to wear out.

- In *Hi-Flyers Ltd v Linde Gas Ltd* [2004] EWHC 105 (QB) Linde contracted to supply 99% pure helium to Hi-Flyers for use in Hi-Flyers’ balloon. The balloon did not perform as Hi-Flyers expected and was found to contain 20 to 25% air. The court held that the helium supplied was likely to have been very close to 99% purity, a single cylinder supplied contained just over 98%, but that “*such fractional impurities*” and “*insignificant differences*” could have made no difference to the balloon’s performance.

Neither case provides much assistance in answering the question whether there are breaches which: (i) do not “*go to the root of the contract*”; but (ii) are also not “*so slight that it would be unreasonable to reject*”. Each case simply provides an example of a defect which **was** “*so slight that it would be unreasonable to reject*”.

All one can go on, then, is the language of the statute. That language does suggest that there probably is an intermediate category of defects which would entitle a buyer to reject goods but where an equivalent defect would not entitle an employer to decline to pay for work to land. That is suggested by the words “*so slight*”. That wording suggests there are other defects, which are also “*slight*”, but not “*so slight*” as to be caught by 15A, where the buyer’s remedy is still to reject the goods.

Supervening Events and Opportunistic Rejection

A scenario to consider is that where a seller delivers goods which are defective in some minor way and, since the buyer ordered the goods, circumstances have changed and it so happens that the buyer no longer wants or needs them. An example might be where a contractor ordering materials for incorporation into a building, the employer subsequently became insolvent and the building contract was terminated. The materials are then delivered to the contractor, who finds they contain some minor defect. Does that make it “*reasonable*” to reject the goods?

While there is no direct authority on the point, it would be surprising if that sort of thing – the employer’s insolvency, a circumstance unconnected to the breach – could make it ‘reasonable’ to reject the goods if it would not otherwise have been so. The issue is likely to be: (i) whether the defect is so slight that it is unreasonable to reject on that ground; rather than (ii) whether, quite apart from the defect, the buyer has a rational motive for wanting to rely upon the defect as a pretext for rejection. Section 15A was inserted into SOGA 1979 pursuant to a Law Commission Report which stated that the buyer’s motives should not be relevant, because “*subjectivity*” was undesirable.

In assessing whether a defect is such that it is “*reasonable*” to reject goods one should probably disregard, then, post-contract, stochastic, events (i.e. events outside the buyer’s or seller’s control) which negative the buyer’s need / desire for the goods. There is no good reason why the law should impose the risk of these events on the seller. The party best placed to manage these risks is the buyer, because the buyer can at least control who it contracts with, and on what terms, and form an assessment of their employer’s / sub-buyer’s likely solvency. A good test might be to ask whether the defect was one which, at the time of entering into the contract and ignoring subsequent events, the parties would have considered so slight that it would be unreasonable to reject.

The result of this approach is arguably a greater degree of certainty and predictability. A given defect either justifies rejection or does not – the answer does not depend upon supervening events or circumstances which

will be present in some cases and not in others. A seller / manufacturer can decide how much care it takes in sourcing / manufacturing the goods, and what quality control measures to implement, accordingly.

Is it Reasonable to Reject Goods if a Minor Defect Makes Them Unsuitable for an Undisclosed Purpose?

A more difficult issue is where goods do not comply with their description in some minor way which: (i) most buyers would consider “*so slight that it would be unreasonable to reject*”; but (ii) makes the goods unsuitable for a specific purpose for which the buyer ordered them, but which the seller was ignorant of. In the *Hi Flyers* case suppose Hi Flyers had been purchasing helium, unbeknownst to Linde, not for use in a balloon but in some kind of medical instrument where a very high purity was actually necessary. In such case is the defect so slight as to make it “*unreasonable to reject*”?

There is no direct authority on the point, but an indication as to the approach a court might take can be distilled from *Bramhill v Edwards* [2004] EWCA Civ 403. Edwards sold Bramhill a motor home which was 102” wide, 2” wider than permitted by reg 8 of the Road Vehicles (Construction and Use) Regulations 1986. The issue was whether the vehicle was therefore not of “*satisfactory quality*”, as required by the term implied into the contract under section 14(2) of SOGA 1979. Section 14(2A) provides that goods are of satisfactory quality if they meet “*the standard that a reasonable person would regard as satisfactory, taking account of ... all ... relevant circumstances*”.

Bramhill was asserting that the illegality coupled with the vulnerability to prosecution rendered the mobile home of unsatisfactory quality within the meaning of section 14(2A). There were, however, similar vehicles being driven in England, it was possible to insure them and there was some evidence that the DVLA ‘turned a blind eye’ to them. The judge at first instance reasoned that:

“the question is whether a reasonable person knowing of the illegality would regard the vehicle as not of satisfactory quality. This depends on their perception of and attitude to the risk of prosecution. It seems to me that reasonable people could hold either opinion. I cannot say that a person who regarded that risk as unacceptable was not a reasonable person. I find, therefore, that a reasonable person knowing of the breach of the regulations would regard such a vehicle as not satisfactory.”

The Court of Appeal held that “*the reasonable person must be one who is in the position of the buyer, with his knowledge; for it would not be appropriate for the test to be that of a reasonable third party observer not acquainted with the background of the transaction*”. The relevant question was thus “*whether a reasonable person in the position of the buyer and with his knowledge of the background facts “would” not regard the goods as unsatisfactory*”. The buyer, Bramhill, was asserting that it would, but the judge at first instance had found “*that a reasonable man could take either view*”. Bramhill, who had the burden of proof, had failed to prove his case.

Where does this leave section 15A? It is certainly possible to read *Bramhill* as suggesting that the buyer’s knowledge of the purpose for which goods are required is to be attributed to the reasonable buyer. Note also that in section 15A, unlike in section 14(2) which was being considered in *Bramhill*, the burden of proving unreasonableness - that the defect is so slight that a reasonable person would not reject the goods - is on the seller. If, under section 15A, it was to be held that a reasonable person could take either view, then the buyer would win.

Problematic Scenarios

There are some scenarios where it is difficult to see any justification for treating defective work to land any differently to defective goods.

Off-plan Purchases

One such scenario is where a developer enters into a contract with a prospective purchaser or tenant, under which the developer agrees to construct a building to a particular specification on land the developer owns, and the prospective purchaser/tenant agrees that it will purchase / take a lease of the land once the building is completed.

If the developer constructs a building which is not in accordance with the specification, and the prospective tenant / purchaser was entitled to terminate as a result, then the developer would have the building, and could try to sell it to someone else. The usual justification for treating defective work to land and defective goods differently – that the employer owns the land and gets the benefit of the contractor's (non-compliant) work – is absent.

Goods Suitable only for a Particular Purpose

Another problematic scenario is where a buyer orders something which only the buyer would want. For example, a buyer orders a structure which the buyer intends to install at a particular offshore location, where the water is a particular depth and the seabed has a particular composition. The seller procures that item and delivers it to the buyer. The item is defective in some slight way, but not “*so slight that it would be unreasonable ... to reject*” it. It is possible to think of similar examples, where the goods sold are works of art, bespoke furniture or bespoke components which the buyer purchases for incorporation into a building (say) or a complex machine.

In these scenarios the usual justification for treating goods differently to land would, again, not apply. If the buyer is entitled to reject the goods then the goods are simply wasted – the seller cannot sell them to anyone else.

Goods to be Affixed to Land

The divide between building contracts and sale of goods contracts is not always clear. It seems that when a seller enters into: (i) a contract to sell goods to the buyer; and (ii) an additional or subsidiary agreement to affix the goods to the buyer's land, such a contract is classified as a contract for sale of goods to which SOGA 1979 applies (as distinct from a contract for work and services to which it does not).

Contracts which have been held to be contracts for sale of goods include all of the following:

- a contract to manufacture a bulk food hopper and (for an additional charge) to deliver and erect it (*H Parsons (Livestock) Ltd v Uttley Ingham & Co Ltd* [1978] QB 791 at 805);
- (ironically) in an Australian case, a contract to supply and install a swimming pool (Tranquility Pools & Spas Pty Ltd [2011] NSWSC 75);
- in a Singapore case, a contract to design, supply and install a security system in an apartment block (*Management Corp Strata Title Plan 1166 v Chubb Singapore Pte Ltd* [1999] 3 SLR 540).

Although these are classified as sale of goods contracts, the practical effect in terms of the buyer's right to reject for minor defects is probably similar to the position under a building contract. That is because the right to reject goods can be lost if a buyer accepts goods (SOGA 1979 section 11), and one way in which goods can be accepted is if they are incorporated into the buyer's land.

Contracts in *Mears*

Mears, a prospective tenant, entered into a contract (the agreement for lease, "**AFL**") with PNSL, a prospective landlord. PNSL agreed that it would construct two buildings (student accommodation blocks) (the "*Landlord's Works*") to a certain specification (set out in the "*Building Documents*") on land which PNSL owned. Mears agreed that it would take a 21 lease of those buildings at a rent of £1.677 million once "*practical completion*" was achieved, provided it was achieved before a certain date.

The AFL provided:

"6.2 The Landlord shall not make any variations to the Landlord's Works or Building Documents which:

6.2.1 materially affect the size (and a reduction of more than 3% of the size of any distinct area shown upon the Building Documents shall be deemed material), layout or appearance of the Property; or ..."

Importantly, however, Clause 15.7 of the AFL also provided that "*... with effect from the Date of Practical Completion, [PNSL] is not to be liable to [Mears] under this agreement for any failure by [PNSL] for any reason to comply with his obligations under*" Clause 5 (the obligation to complete the works in accordance with the Building Contract) and Clause 6 (the obligation not to make variations which materially affect the size of the Property).

PNSL retained **Pickstock**, a contractor, to build the blocks under a standard form JCT Design and Build Contract, 2011 ("**Building Contract**"); and appointed **Costplan**, a QS, to act as Employer's Representative under that Building Contract. Pickstock and Costplan gave Mears collateral warranties, and Pickstock was also a party to the AFL.

Meaning of "Practical Completion"

The Court in *Mears* summarised the law as regarding practical completion as follows:

- "a) Practical completion is easier to recognise than define ... There are no hard and fast rules ...*
- b) The existence of latent defects cannot prevent practical completion ... In many ways that is self-evident: if the defect is latent, nobody knows about it and it cannot therefore prevent the certifier from concluding that practical completion has been achieved.*
- c) In relation to patent defects, the cases show that there is no difference between an item of work that has yet to be completed (i.e. an outstanding item) and an item of defective work which requires to be remedied. Snagging lists can and will usually identify both types of item without distinction.*

d) *[practical completion] can be summarised as a state of affairs in which the works have been completed free from patent defects, other than ones to be ignored as trifling.*

e) *Whether or not an item is trifling is a matter of fact and degree, to be measured against “the purpose of allowing the employers to take possession of the works and to use them as intended” ... However, this should not be elevated into the proposition that if, say, a house is capable of being inhabited, or a hotel opened for business, the works must be regarded as practically complete, regardless of the nature and extent of the items of work which remain to be completed/remedied.*

f) *... Ruxley does not support the proposition that the mere fact that the defect was irremediable meant that the works were not practically complete.”*

Dispute in *Mears*

The buildings which Pickstock constructed contained some 55 or 56 rooms which were all at least 3% smaller than had been specified. PNSL / Costplan nonetheless proposed to certify that practical completion had been achieved under the Building Contract, which would trigger Mears' obligation to enter into the 21 year lease.

According to Mears, the smaller rooms would have a lower rental value than if they had been built in accordance with the specification, or else be so unattractive that they could not be rented out at all. According to the defendants the divergence from the specification will make no difference to rental value or rentability. There is, as yet, no decision on that.

Mears sought an injunction to prevent practical completion being certified. Mears relied upon Clause 6.2.1 to argue that the parties had deemed any reduction of more than 3% in the size of any room to be a departure from the Building Documents which “*materially affect[ed] the size*” of the property. The buildings as-built were thus “*materially*” different in size to what had been specified in the Building Documents. Something which the parties had agreed was “*material*” could not be “*ignored as trifling*”, and so the work was not “*practically complete*”.

Why did Mears want to Escape from its Obligation to Enter into the Lease?

Mears' evidence when applying for the injunction was that the smaller rooms would have a lower rental value, or be so unattractive that they could not be rented out at all. The blocks would thus generate less revenue for Mears than if PNSL had built the blocks correctly, with the right size rooms, as Clauses 5 and 6.2 required.

If practical completion was certified and Mears entered into the lease, Clause 15.7 would prevent Mears claiming anything from PNSL to compensate Mears for the loss PNSL's breach of contract had caused.

It was Pickstock's position that the rentability / rental values would be entirely unaffected by the smaller rooms. The implication is that Mears wanted to escape from its obligation to enter into the lease for some reason which was entirely unrelated to the rooms being smaller than expected. For example, it might have been that:

- Since entering into the AFL more than two years earlier, rental values for such property had fallen generally. Mears' expectation was now that, if it rented the blocks for £1.677 million/year, they would be unprofitable, or not profitable enough to justify the time, effort and resources involved. Mears preferred to spend its money elsewhere, on something else.

- Mears had miscalculated when it entered into the AFL – the blocks would never have been profitable, or sufficiently profitable even at the rents then expected.
- The expected rental values for the blocks were still in line with what Mears had expected when it entered into the AFL. Mears simply saw an opportunity to renegotiate a more favourable lease now that PNSL was in a weaker position. PNSL would by now have incurred all the costs of building the blocks, and would need to cover its finance costs and show a return on its investment. There will (presumably) have been few or no potential alternative tenants besides Mears.
- Mears obtained the injunction on 22 August 2018, so practical completion had evidently still not been certified and the lease had still not commenced on that date. University terms in England start in September, and most students will arrange leases of their accommodation somewhat earlier. If Mears was forced to take a lease of the blocks from late August / early September 2018, it might be unable to find tenants until September 2019. A factor in Mears' decision may thus have been a desire to avoid paying rent on the blocks for a period of a year during which they would generate no revenue.

There are no findings (yet) on the issue of whether the rentability / rental values were affected by the smaller rooms. And, of course, Mears' present motives are (or should be) irrelevant to an enquiry as to what the contract means.

Decision in *Mears*

The courts at first instance and on appeal each declined to grant the declarations sought. It was held that:

- 6.2.1 prohibits variations which “*materially affect the ... size*”. Any such variation is a breach of contract by PNSL.
- 6.2.1 deems a failure to meet the 3% tolerance to “*materially affect ... the size*”. Therefore, each of the 56 failures to meet the 3% tolerance was a breach of contract by PNSL.
- 6.2.1 only establishes that such failures are breaches. It says nothing about whether they are material breaches: “*The words of clause 6.2.1 do not say that [the resulting breach contract was itself material]. Materiality is introduced only in relation to room size “materially affect the size”, and not in relation to the resulting breach. There is nothing in clause 6.2.1 which addresses the character or quality of the breach*”.

In support of that construction, the Court of Appeal reasoned that:

“if the parties were to be taken to have agreed that any failure to meet the 3% tolerance no matter how trivial, amounted to a material breach of contract, it would lead to a very uncommercial result. It would mean that every room would be the subject of minute measurement and remeasurement, and that one trivial failure to meet the 3% tolerance, allowed Mears to determine the AFL. ... In my view, clear words would be necessary for such a draconian result and there are no such words in clause 6.2.1.”

“... Mears' reading of clause 6.2.1 would treat any failure to meet the 3% tolerance, no matter where or how it arose, in the same way. So a failure to meet the 3% tolerance in relation to the bin store on the ground floor, even if that failure was trivial, would be said to be a material breach of contract which ... “would allow Mears to walk away”. ... I consider that interpretation to be wrong both as a matter of the language, and as a matter of commercial reality.”

Clause 6.2.1 did not *deem* a failure to meet the 3% tolerance to be a “*material breach*”, such as to prevent practical completion. That left open the possibility, however, that the defects were, in fact, more than trifling, and so that practical completion had not, in fact, been achieved. The judge at first instance put it as follows:

“if there are in truth and on the facts, breaches of Clause 6.2.1 sufficient to say that practical completion should not have been certified then the whole question of practical completion (even if purportedly certified ...) could be looked at again by the Court ... And if a Court took the view that practical completion had not been validly certified, then there could well be consequences for entry into the lease itself or possibly an ability to rescind it since the underlying trigger (practical completion) had now gone.”

Discussion of *Mears*

A difficulty with the decision in *Mears* becomes apparent if one assumes that the shortfall in room size is a trifling defect which does not prevent practical completion:

- PNSL had agreed to build the blocks in accordance with the specification, specifically in Clause 6.2.1, to build the blocks with rooms no less than 3% smaller than shown in the Building Documents.
- In breach of Clause 6.2.1, PNSL built the blocks with rooms more than 3% smaller than shown in the Building Documents.
- Notwithstanding that breach of Clause 6.2.1, Mears is obligated to enter into the lease because the defects are trifling, and so practical completion had been achieved.
- Having entered into the lease, Mears cannot claim any damages from PNSL for the breach of Clause 6.2.1, because of Clause 15.7 of the AFL.

It can be seen that, on the court's construction, Clause 6.2.1 is rendered completely meaningless. A breach of Clause 6.2.1 does not entitle Mears to any remedy, and has no negative consequence for PNSL.

On the court's construction, one could delete Clause 6.2.1 from the Contract entirely, and Mears' and PNSL's rights and obligations would be exactly the same as with that Clause included.

Clause 15.7 operates to deprive Mears of any remedy as against PNSL for a breach of Clause 6.2.1 once Mears enters into the lease, and the trigger for entering into the lease is practical completion. The only way to give Clause 6.2.1 any effect is thus to construe a breach of Clause 6.2.1 as operating to prevent practical completion.

The Court of Appeal's explanation as to the purpose of Clause 6.2.1 is:

“It would be commercially unworkable if every departure from the contract drawings, regardless of the reason for, and the nature and extent of, the non-compliance, had to be regarded as a breach of contract. ... The parties recognised this problem and, at clause 6.2.1, they addressed it directly. They identified the circumstances in which a departure from the room size specified on the contract drawings would amount to a breach of contract. ... The clause simply provides a mechanism by which a breach of contract can be indisputably identified.”

That simply leaves open the question – why bother with any mechanism for indisputably identifying breaches if such breaches are to be breaches in name only, with no consequence for either party?

It is no answer to say that Mears would have a claim against Pickstock in respect of the defects (under the warranty). That would be the case with or without Clause 6.2.1 and does not explain why Clause 6.2.1 was nonetheless included in the AFL.

One would not go so far as to say that the court's construction is wrong, but the reasoning does seem incomplete, insofar as it does not deal satisfactorily with the canon that in construing a contract all parts of it must be given effect and no part of it should be treated as inoperative or surplus.

Finally, it is not clear whether Mears' proposed construction is really so "*draconian*" "*uncommercial*" and "*wrong as a matter of commercial reality*" as to justify ignoring Clause 6.2.1.

Although this was a contract for building works, the work was not being done to Mears' property. Mears would not get the benefit of the work and, if Mears was entitled to walk away, PNSL would still have the non-compliant buildings it had constructed and it could try to let them to someone else. Hence an analogy with sale of goods does not seem completely unreasonable.

A buyer of goods is entitled to reject them if they do not comply with their description in any way which is more than "*so slight that it would be unreasonable to reject*". Consider the position if the contract in Mears had been a contract for sale of goods and had likewise provided that, if the goods were more than 3% smaller than described then that was something which "*materially affected the size*" of the goods. Would a court hold that 3% divergence was nonetheless too slight to justify rejection? Note also that in a sale of goods contract, one would start from the presumption that the divergence did justify rejection, and PNSL would have the burden of proving that it was too slight (i.e. that the rentability / rental value was unchanged).

In a lecture he gave in 2017 Lord Sumption was critical of what he saw as a tendency on the part of judges when interpreting contracts not to focus upon the meaning of the words, but to adopt an approach which "*modifies or contradicts the words in pursuit of what appears to a judge to be a reasonable result*" (*A Question of Taste: The Supreme Court and the Interpretation of Contracts* 8 May 2017):

"...judges' notions of common sense tend to be moulded by their idea of fairness. But fairness has nothing to do with commercial contracts. The parties enter into them in a spirit of competitive cooperation, with a view to serving their own interest. Commercial parties can be most unfair and entirely unreasonable, if they can get away with it. The problem about measuring their intentions by a yardstick of commercial common sense is that in practice it transforms the judge from an interpreter into a kind of amiable compositeur. It becomes a means of saving one party from what has turned out to be a bad bargain. The question is no longer what the parties agreed. It is: what would they have agreed if they were the objective, just and fair-minded people that in practice they are not."

"... Long-term contracts commonly include clauses giving one party an option to terminate in certain events, for example if a given standard of performance is not achieved, or not achieved by a given date. In my experience, commercial parties attach importance to such clauses. They may want to deter non-performance. They frequently want a let-out if the situation changes in a way that may adversely affect them. But commercial judges in England are traditionally hostile to peremptory termination clauses. The problem about them is that they are rarely invoked for the reasons for which they were originally included. A party with a right to terminate will only do it if it suits his broader commercial interest. Time-chartered ships are never withdrawn for non-payment of hire if the market has gone down since it was agreed. They are only withdrawn if there is a chance to recharter them at a higher rate, perhaps to the same charterer. To a judge looking for the fair result after the termination right has been exercised (or

purportedly exercised) this seems unfair. It smacks of bad faith. So they tend to construe the clauses more narrowly than the parties envisaged when they agreed it.”

Hence, whenever a court resorts to “commercial reality” as a reason for (in effect) ignoring a provision in a contract, particularly one which might allow a party to escape from its obligations, the reasoning does require particular scrutiny.

Lessons to be Learned from This

In ‘off-plan’ contracts regarding the transfer of interests in buildings which have yet to be constructed, a prospective purchaser / tenant should always consider what level of divergence from specification it would be prepared to tolerate, and provide clearly for what its remedies are to be, and against whom, in the event that the building does not meet that specification. Those drafting such contracts should be aware of the courts’ relative hostility to interpretations which allow prospective purchasers / tenants to escape from such a contract if the building is not constructed to the required standard.