CONSTRUCTION : BULLETIN

JCT Contracts – What Is An "Appropriate Deduction" Where The Contractor Is Instructed Not To Remedy Defects?

A number of the most widely used JCT standard forms, including Standard, Design & Build and Intermediate, give the Employer the option of instructing the Contractor not to remedy defects which have arisen during the defects liability/rectification period and instead make an "appropriate deduction" from the contract sum in respect of those defects. However, the question of what constitutes an "appropriate deduction" had not come before the courts until the recent case of *Mul v Hutton Construction Limited*.

Background

In 2008, Ms Mul (the Employer) engaged Hutton Construction Ltd (the Contractor) under the JCT Intermediate Building Contract 2005 edition to carry out substantial extension and refurbishment work at her country house in Kent.

Clause 2.30 of the Contract stated:

"Any defects, shrinkages or other faults in the Works or a Section which appear and are notified by the... Contract Administrator to the Contractor not later than 14 days after the expiry of the Rectification Period, and which are due to materials or workmanship not in accordance with this Contract, shall at no cost to the Employer be made good by the Contractor unless the... Contract Administrator with the consent of the Employer shall otherwise instruct. If he does so otherwise instruct, an appropriate deduction shall be made from the Contract Sum in respect of the defects, shrinkages or other faults not made good."

Practical completion was certified by the Contract Administrator in May 2010, although the certificate had a long list of incomplete or defective works attached to it. The Rectification Period was 12 months. The Employer subsequently claimed to have identified significant defects in the work, but the Contractor denied liability. In March 2011, the Contract Administrator wrote to the Contractor stating that the Employer was arranging for the defects to be remedied by third party contractors.

The Employer issued legal proceedings against the Contractor in October 2013, claiming damages of over £1m. In defence of the claim, the Contractor argued that it had always been ready, willing and able to repair the defects as envisaged by clause 2.30. The Contractor also argued that the Employer's entitlement to damages defects was limited to an "appropriate deduction" under clause 2.30 and that the "appropriate deduction" should be calculated by reference to the contract rates and prices.

The issue to be decided

There is no previous case law on the meaning of the term "appropriate deduction" in the context of an instruction to the Contractor not to rectify defects, so the court ordered a preliminary trial to determine whether, in respect of a defect arising within the Rectification Period, an "appropriate deduction" under clause 2.30 should be calculated by reference to:

a) the Contract rates/priced schedule of works/Specification; or

b) the cost to the Contractor of remedying the defect; or

c) the reasonable cost to the Employer of engaging another contractor to remedy the defect; or

d) the particular factual circumstances and/or expert evidence relating to each defect and/or the proposed remedial works.

Hawkswell Kilvington

Solicitors to the Construction and Engineering Industries

Hawkswell Kilvington
17 Navigation Court
Calder Park
Wakefield
WF2 7BJ

90 Long Acre
Covent Garden
London
WC2E 9RZ

T: 0844 809 9566
E: enquiries@hklegal.co.uk
W: www.hklegal.co.uk

The Contractor argued that the valuation of an "appropriate deduction" had to be calculated by reference to the rates and prices in the Contract (alternative (a) above) because it was being denied its contractual right to carry out remedial work.

The Employer argued that an "appropriate deduction" is what is appropriate in all the circumstances and could, depending on the particular defect, be any one of the alternatives listed in (a) to (d) above.

The court's decision

The court found in favour of the Employer, deciding that an "appropriate deduction" under clause 2.30 is "*a deduction which is reasonable in all the circumstances*", and can be calculated by reference to one or more of factors (a) to (d) listed above "*amongst possibly other factors*".

If there were defects in the Works at practical completion, the Employer has a right to claim damages for breach of contract. If the damages payable to the Employer could only be calculated by reference to the rates and prices in the Contract, this would effectively impose a limitation on the Employer's right to damages. A contract must contain very clear wording if a right to damages is to be limited. Clause 2.30 simply does not contain clear enough wording to limit the Employer's entitlement to damages.

The court was of the view that the drafters of the Contract had chosen the term "appropriate deduction" because they appreciated that there could be a number of different deductions which were "appropriate", depending on the circumstances. If the drafters of the Contract had intended clause 2.30 to always have the meaning argued by the Contractor, the clause would have expressly stated that the "appropriate deduction" was to be calculated by reference to the rates and prices in the Contract. The fact that it did not demonstrated that there could be a number of different ways of calculating an "appropriate deduction".

The court also pointed out that relying on the rates and prices in the Contract might not always achieve a fair result because the cost of rectifying a defect might be far less than the corresponding price for that type of work. In such circumstances, a deduction calculated on the basis of Contract rates would be unfairly high.

Not plain sailing for the Employer

Although the court decided this preliminary issue in favour of the Employer, it stressed that there is no guarantee of the Employer recovering the full amount of damages claimed when the case goes to a full trial. There is uncertainty over a number of other issues which could end up being decided in the Contractor's favour.

First of all, the preliminary trial went ahead on the assumption that the Contract Administrator's letter to the Contractor in March 2011 constituted an instruction to the Contractor under clause 2.30 not to remedy defects in the Works. However, this was not an agreed fact and there is the opportunity for further argument about whether the letter constituted a valid instruction under clause 2.30.

Secondly, the Employer will have to overcome allegations that she acted unreasonably in denying the Contractor the chance to rectify the defects and has therefore failed to mitigate her loss. The Employer's entitlement to damages may be reduced on the basis that the cost of rectifying the defects would have been less if she had allowed the Contractor to carry out the remedial work, rather than engaging a third party at a higher price.

Finally, there may be a question as to whether clause 2.30 was ever engaged in the first place. The practical completion certificate issued by the Contract Administrator had a long list of defects attached to it, causing the court to comment that the practical completion certified was "*apparently not of a type expressly envisaged by the Contract*". If practical completion has not been validly certified, the Rectification Period will not have begun and clause 2.30 might not be engaged. The court suggested that there could be scope for argument on issues such as whether practical completion was validly certified and whether the parties had, by their conduct, acted as if practical completion had occurred such that the Rectification Period could start running.

Analysis

This decision, which is of relevance to many forms of JCT contract, clarifies to some extent the uncertainty over what constitutes an "appropriate deduction" for defects and may potentially give Employers more confidence to instruct Contractors not to remedy defects in circumstances where relations between the parties have broken down. However, Employers must remember that an instruction not to rectify defects must be given reasonably. If not, the deduction from the contract sum will be reduced to reflect the Employer's failure to mitigate loss.

Another point of interest in this case is the court's comment that issuing a certificate of practical completion with a list of defects attached results in a type of practical completion "*not expressly envisaged by the Contract*". Any Employer or Contract Administrator who regularly engages in this practice should seriously consider including a bespoke amendment in the Contract which provides for practical completion to be certified subject to a list of defects.

CONTACT DETAILS

Hawkswell Kilvington Limited

17 Navigation Court
Calder Park
Wakefield
WF2 7BJ

90 Long Acre
Covent Garden
London
WC2E 9RZ

T: 0844 809 9566
W: www.hklegal.co.uk
E: enquiries@hklegal.co.uk