PRACTICAL ISSUES FOR PRACTICAL COMPLETION

Over the last 12 months, we have experienced a surge in disputes about whether practical completion of a new development has occurred, and it is often nothing to do with whether the building is complete - it is more about parties seeking to escape the consequences of practical completion. Practical completion of a project is of huge commercial significance - its occurrence fundamentally changes the rights that exist not only between the parties to the Building Contract but amongst third parties, such as tenants and purchasers as well.

It comes as something of a surprise, therefore, to discover that there is no standard industry definition of "practical completion". Most of the standard form building contracts simply refer to a certificate of practical completion being issued when practical completion of the works is achieved, without providing a definition of practical completion. Through the development of caselaw and academic writing it is thought that:

- a certificate of practical completion may not be issued if there are patent defects (i.e. defects that are known about);
- works can be practically complete despite the fact that there are latent defects, and the Defects Liability Period is provided in order to enable defects not apparent at the date of practical completion to be remedied;
- practical completion means that the completion of all of the construction work that has to be done has taken place (although in practice this is often not the case); and
- an Architect/Contract Administrator is given discretion to certify that practical completion has taken place where there are very minor items left incomplete.

In the current market we have seen a significant rise in the numbers of disputes focusing on whether or not practical completion has occurred, and there is a concern that companies may use confusion concerning practical completion as a justification (or an excuse) not to complete, or at least to delay or improve deals such as agreements for lease.

Effects of practical completion

The term is therefore of key importance to developers, contractors, purchasers, funders and tenants, all of whom will have competing commercial interests in achieving practical completion at a specific point in time. A Developer may want practical completion to be certified quickly so that rental payments begin, or his profit can be paid in terms of a forward funding agreement. A Tenant may not be in a position to commence his fit-out or open for trading. A Contractor will want to avoid liability for liquidated ascertained damages (LADs) and have the insurance risk transferred back to the Developer but, for example, a Developer may want to delay practical completion if it has still to let the building.

When practical completion is certified, it ends any right of the Developer to LADs for delay in completion of the works. The Developer may in turn have to pay a percentage of any retention monies (normally 50%) to the Contractor. The Developer’s rights to claim on a performance bond may also fall away, and in the 1998 case of George Fischer Holding Limited (formerly George Fischer (Great Britain) Limited) v Davis Langdon & Everest and Others [61 Con. L.R.85], a Developer’s Agent was found to be negligent for issuing a completion certificate without properly inspecting the works, and failing to advise its client that they could no longer call on a Performance Bond provided by the Contractor, as the right to do so was lost on practical completion.

Once practical completion is granted, the defects liability period commences. Afterwards, the Contract Administrator can only give instructions to the Contractor in relation to any incomplete works and defects that arise in the works occurring during the liability period. The Contract Administrator can no longer request the Contractor to carry out any variations to the works. In practice, practical completion certificates are often issued conditionally on items of snagging being completed. However, there is no provision for snagging lists in most building contracts that are entered into, and a contractor has no contractual duty to rectify the items on such a list quickly. If a snagging list mechanism is introduced by way of amendments made to a standard form contract, its effect on the contract, and its relationship with the certification of practical completion, should be clear.

Another key effect of practical completion is the liability to insure the project. Once practical completion is certified, the risk of loss or damage to the works passes from the contractor to the Developer. It is important to ensure that if the Developer is passing on this risk (for example to a prospective purchaser) that there is no gap in insurance cover for the works.

Practical completion and third party agreements

There is often a definition of practical completion in agreements for lease, and sale and purchase contracts, given the importance of the practical completion of a building in triggering the date of entry. The risk is that a robust definition in an agreement for lease or sale and purchase contract may leave the Developer exposed if this is not also mirrored in the building contract, with the result that practical completion is achieved under the building contract, but not under the associated lease or sale agreement. Commercially, this may allow a purchaser or tenant to withdraw from a transaction, delay completion or seek a reduction in price/rent.

A common example of this conflict between the two contracts is where the date of entry can only occur when the local authority has accepted the completion certificate, but under the building contract the works can often be practically complete without this. Similarly, if the Developer needs to deliver drawings, collateral warranties or operational and maintenance manuals before the date of entry, the Developer may want this to be a condition to the Contractor achieving practical completion.

How to avoid disputes
It is important to recognise the interconnected nature of agreements, and to ensure any obligations in agreements for lease and sale and purchase contracts are stepped down into the building contract. It is also important that the professional team, and in particular the Contract Administrator, is aware of the relevant provisions in any third party agreements. Communication between the technical team and the legal team is key - simply providing a Contract Administrator with the various contracts is not enough, they should be advised of any practical completion requirements in the other documents.

Contract Administrators should beware of certifying practical completion of the works before they are finished. Once practical completion has been issued the Contractor may lose motivation to complete minor snagging works and procure collateral warranties from its sub-contractors. A practical completion certificate should not be issued conditional on a snagging list without the certificate being carefully drafted to ensure the Contractor is obliged to complete the items on the attached list.

Meetings should be arranged on site involving the Contract Administrator, Developer, and Contractor to discuss any minor additions/modifications that need to be carried out before the practical completion certificate can be issued. If required to do so by a contract, ensure that any potential purchasers and tenants are notified of all inspections and given an opportunity to attend. It is critical to ensure that the notification provisions for completion are strictly followed. A notice that is late can cost the Developer thousands of pounds in lost rent. Likewise, purchasers and tenants should attend any meetings for which they receive notification, and raise any concerns that they have.

Practical completion is, and is likely to remain, one of the biggest sources of disputes in relation to new developments. In order to mitigate the likelihood of a dispute arising, parties should ensure that the relevant provisions in their development contracts mirror the provisions in the building contract.

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