Case: *William Hare Limited v Shepherd Construction Limited [2010] EWCA Civ 283*

Interpretation of contracts; Exclusion clauses; Housing Grants, Construction and Regeneration Act 1996; Withholding payment; Insolvency; 'Pay when paid'

The facts

William Hare Limited ("WHL") was engaged as steelwork subcontractor by Shepherd Construction Limited ("Shepherd") on a development project at Trinity Walk in Wakefield in December 2008. The employer was Trinity Walk Wakefield Limited ("Trinity").

The agreement between WHL and Shepherd included amendments proposed by Shepherd. These had been drafted by Shepherd's previous solicitors in about 1998 and included 'pay when paid' provisions drafted to comply with the Housing Grants, Construction and Regeneration Act 1996 ("the Construction Act"). The Construction Act applied to the subcontract. The purpose of Section 113 (2) of the Construction Act is to make 'pay when paid' clauses ineffective except in certain circumstances where the third party relied on for payment becomes insolvent. For the purposes of the Construction Act the meaning of insolvent is set down.

The Construction Act at Section 113 (2) provided:

> "*For the purposes of this section a company becomes insolvent-*
>
> *(a) on the making of an administration order against it under Part II of the Insolvency Act 1986,*
>
> *(b) on the appointment of an administrative receiver or a receiver or manager of its property under Chapter I of Part III of that Act, or the appointment of a receiver under Chapter II of that Part,*
>
> *(c) on the passing of a resolution for voluntary winding-up without a declaration of solvency under section 89 of that Act, or*
>
> *(d) on the making of a winding-up order under Part IV or V of that Act.*"

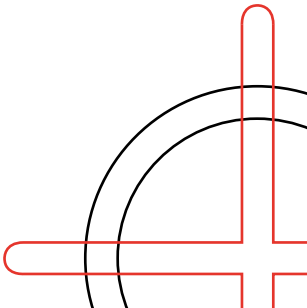
The 'pay when paid' provisions proposed by Shepherd, and drafted in about 1998, mirrored Section 113 (2) of the Construction Act described above.

In the period subsequent to implementation of the Construction Act the *Insolvency Act 1986* was amended by the *Enterprise Act 2002*. The amendment provided, via a Schedule B1, three different routes to administration. One was by appointment of an administrator by court order and the other two were "*self certifying options*" both of which were new and did not require a court order.

As a consequence of this the Construction Act was also amended so that Section 113 (2) (a) now provides:

> "*For the purposes of this section a company becomes insolvent —*
>
> *(a) when it enters administration within the meaning of Schedule B1 to the Insolvency Act 1986*"

When WHL and Shepherd agreed the subcontract in 2008 the terms reflected the earlier version of Section 113 (2) and not the amended version following the *Enterprise Act 2002*. Accordingly when the employer Trinity went into administration by one of the new self certifying routes the words used in relation to the 'pay when paid' provisions did not cover the particular circumstance. Nonetheless Shepherd withheld payments otherwise due to WHL of approximately £1 million in reliance on those provisions. WHL argued that Shepherd could not rely on the clause to withhold payment as the words did not cover the particular circumstance. The case went to court in the TCC in 2009 and the Court of Appeal in 2010.



The dispute

The dispute centred on the interpretation of the relevant provisions of the subcontract. It was clear that the words used did not cover the particular circumstance of the insolvency of Trinity. The dispute related to the contention made by Shepherd that the contract should be construed in such a way that the amended legislation was covered by the wording of the relevant provisions. To support its contention Shepherd referred, *inter alia*, to the case of in *Investors Compensation Scheme v. West Bromwich Building Society [1997] UKHL 28* ("ICS").

ICS is a House of Lords case concerning the principles adopted by the courts in the interpretation of contracts. Some of the most notable aspects of the ICS judgement pertinent to the WHL v Shepherd case were that the courts would take into account the relevant background to the contract and also that the meaning a document conveys is not the same as the literal meaning of the words used but what the parties would have understood to have been meant against the relevant background. Shepherd therefore sought to argue the relevant background included the fact the legislation regarding insolvency had changed and this should lead to a construction of the clause that covered all routes to administration. Shepherd contended it would be an "*absurd*" result if the clause were construed not to cover certain routes to administration due to the lack of a court order. Mr. Justice Coulson, sitting in the TCC, disagreed with Shepherd and found that "*Since Trinity are not the subject of* [an administration] *order, Shepherd's withholding notices are invalid*".

Shepherd appealed and in the Court of Appeal sought also to rely on the case of *Chartbrook Ltd and another v Persimmon Homes Ltd and another [2009] UKHL 38* ("Chartbrook"). This was another House of Lords case concerning interpretation of contracts and following the principles set out in the ICS case Shepherd cited Chartbrook as authority that those principles can even lead to alteration of words themselves if the court is compelled to the view that the parties simply cannot have meant what the words say. There were other relevant considerations including that the provisions as drafted worked, albeit they did not cover all circumstances in which a third party may become insolvent. Also, because the clause under consideration was, in effect, an exclusion clause (it relieved Shepherd of liability in certain circumstances) the dominant principle was that a party must use clear words to relieve themselves of liability. Therefore the Court of Appeal disagreed with Shepherd and the judgement notes "*It is not therefore in my view open to Shepherd to argue that there is a lack of clarity in a provision that they drafted so as to relieve themselves of liability, and that the court should use the principles identified by Lord Hoffman as applicable in rare cases to rescue them*".

Practical implications

Parties should be careful in their drafting of contract documents. In particular they should exercise caution in using or re-using old contract forms, including in-house sub-contract forms perhaps drafted when the Construction Act first came into effect. A 'health check' of standard provisions and current legislation would be helpful.

It may also be sensible to include provisions drafted to refer to legislation and amendments and updates to that legislation rather than seek to directly quote their language. That way the likelihood of a scenario such as that found in the Shepherd case would be much reduced.

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