

INSOLVENCY

Court of Appeal confirms need to carefully define insolvency in “pay when paid” clauses - *William Hare Ltd v Shepherd Construction Ltd* [18.3.10]

In March 2009, Trinity, the developer of a new shopping centre in Wakefield, was placed into administration by its directors. This prompted Trinity’s design and build contractor, Shepherd, to withhold payments from its steelwork sub-contractor, Hare, insolvency being the exception to the prohibition on “pay when paid” clauses.

Unfortunately for Shepherd, the sub-contract identified administration as the making of an administration order under Part II of the Insolvency Act 1986. Crucially, this wording did not reflect an amendment which had been made to Part II by the Enterprise Act 2002, identifying two further routes to administration, neither of which required an administration order.

Since no administration order had been made in Trinity’s case, Hare argued that Trinity was not insolvent as defined in the sub-contract and, accordingly, Shepherd was not entitled to operate the pay when paid clause. Shepherd argued that the wording should be construed as covering all routes to administration identified by the amending legislation. At first instance, the court found in favour of Hare.

Decision

Shepherd repeated its arguments as to contractual interpretation before the Court of Appeal. It referred to the House of Lords’ decision in *Chartbrook Ltd v Persimmon Homes Ltd* [2009] to demonstrate that, where it is clear to any reasonable person that something had gone wrong with the drafting, such that the parties cannot have meant what the wording says, the court can alter the words themselves to give the contract its intended meaning.

Dismissing the appeal, the Court of Appeal expressed a strong inclination towards simply agreeing with the trial Judge’s reasoning. However, it put forward what it considered to be the more straightforward answer.

Recognising the established principles of contractual interpretation, the court emphasised the need for “*a strong case*” to persuade the court that something must have gone wrong with the drafting and expressed doubt that those principles were applicable here because the pay when paid clause was, in effect, an exclusion clause. As such, it was subject to another well-established principle, i.e. that a party wishing to exclude or limit its liability in circumstances where it would otherwise be liable, must do so in clear words. This, it thought, was the dominant principle.

Comment

With regard to pay when paid clauses, this case simply highlights the need for clarity when it comes to defining insolvency for the purposes of operating such a clause.

However, of general importance is the re-affirmation of the position that only in rare cases will the courts be persuaded that something has gone wrong with the language of a contract and that, in the case of an exclusion clause, the courts will not come to the rescue of unclear and ambiguous wording.

This provides a reminder to those drafting contracts to ensure standard form contracts and schedules of amendments reflect current legislation (or will give effect to amending legislation, where appropriate), and accurately reflect what is intended.

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