

Melville Dundas Ltd (in receivership) v George Wimpey – the final instalment

The inter-relationship between parties' freedom of contract and the Housing Grants Construction & Regeneration Act 1996 was brought sharply into focus once again in the recent House of Lords appeal case *Melville Dundas Limited (in receivership) and ors (Respondents) v George Wimpey UK Limited and others (Appellants)*, 25 April 2007. The House of Lords' decision is Part 3 of the Melville Dundas trilogy. Three of the five Law Lords who heard the appeal upheld parties' freedom of contract over the provisions of the Act.

So, what was decided? What does the decision mean for those involved in construction projects going forward?

First, it's useful to recap on the facts and what was decided in the lower courts.

The facts

Melville Dundas were employed by Wimpey under a JCT With Design contract. During the course of the works – on 22 May 2003 – MD had receivers appointed. Prior to this a valuation of MD's works was issued with a final date for payment of 16 May 2003. No notice of withholding was issued but regardless of this Wimpey did not pay up. On 30 May 2003 Wimpey terminated MD's employment on the basis of MD's receivership under clause 27 of their contract.

MD sued for payment of the valuation – £396,630. Wimpey relied on clause 27 which provided that, on such termination, Wimpey could withhold any further payment (save for sums due 28 days or more prior to termination) until the works were complete. Thereafter clause 27 provided that an accounting would take place whereby additional costs of completion would be deducted from sums otherwise due to MD.

MD relied on section 111(1) of the Act which provides that no payment can be withheld after the final date for payment unless a valid withholding notice has been issued. MD argued that Wimpey could not withhold the payment without a withholding notice as to do so would be contrary to the terms of section 111(1). In their opinion, it didn't matter that the contract appeared to say otherwise.

The decisions

Part 1

The first judge – Lord Clarke – disagreed with MD and refused to grant judgment. He stated "*Section 109, section 110 and section 111 of the 1996 Act are, in my judgement, concerned with, and directed, at cash-flow questions, arising during the course of a continuing non-determined construction contract.... Clause 27, however, is concerned, with a quite different situation, ie where the contract is legitimately determined by the employer. In my opinion the legislative provisions were not intended to regulate that situation. The parties' continuing freedom of contract in that respect has, in my judgment, not been affected by the legislative provisions*". Or putting it another way, he found the parties were free to agree that on termination the final date for payment was altered and this is what was done by clause 27.

Part 2

The case was then appealed to the Scottish appeal court which over-turned the decision and ordered Wimpey to make payment of £369,380 plus interest to MD. Why? Well, unlike the lower court, the appeal court found that section 111(1) did apply after termination. The court found that in the absence of a timeous notice of withholding, this was prohibited by section 111(1), which continued to apply after termination. Accordingly the payment had been wrongfully withheld by Wimpey. Clause 27 did not set a new final date for payment as it was impossible to ascertain from the terms of the clause what that date might be.

Part 3

Wimpey was having none of it and appealed the matter to the House of Lords. The upshot? Wimpey got to keep their money – by a majority of 3 to 2, the House overturned the decision of the Scottish appeal court and restored the original decision of Lord Clarke. Lord Hope of Craighead (one of the judges who allowed the appeal) stated "*I agree with Lord Clarke that section 111(1) does not apply to the situation where the*

employer wishes to exercise his rights of set-off that he is given by clause 27.6.5.1 when he has determined the contractor's employment under the contract".

So on what basis was the decision reached?

Lord Hope got there by looking at the purposes of clause 27 of the contract and section 111 of the Act. In essence he found that clause 27 enshrined the principle of balancing of accounts on bankruptcy which is to "prevent the hardship of a debtor who is also a creditor being forced to pay in full, when he will come in only as a creditor for a dividend for his debt as a result of ranking *pari passu* with the ordinary creditors". Clause 27 was an expression of parties' freedom of contract to regulate such a situation. Parties are normally free to agree the terms of their contract as they see fit. So the next question was whether section 111(1) interfered with that right? Lord Hope found that the terms of the section were unambiguous and at first glance did appear to "trump" the contract provisions. However he then said it was important in interpreting the section to ascertain whether Parliament could have intended such a result. He found, by reviewing all manner of documents, that Parliament could not have intended such a result.

Of the 2 other judges who allowed the appeal, only Lord Hoffman gave a full judgment. Again he sought to ascertain what Parliament could have intended by section 111(1)? He stated "*I very much doubt whether Parliament, in enacting section 111(1), took into account that parties would enter into contract under which the ground for withholding a payment might arise after the final date for payment....section 111(1) should be construed as not applying to a lawful ground for withholding payment of which it was in the nature of things not possible for notice to have been given within the statutory timeframe*". Wimpey could not have given a timeous notice of withholding because they did not know that MD were going to have receivers appointed.

The implications

So where does all of this take us?

Well, for insolvency practitioners (and creditors) of insolvent contractors, it's bad news. It means a potential source of funds is lost. The contrary is true for employers faced with an insolvent contractor – they will be able to enforce their contractual right of set-off. The terms of their contract (assuming the contract to be the same or very similar to the contract in question here) will be upheld.

What remains to be seen is how far the decision extends? Is it limited to situations of termination arising from one of the insolvency events listed in clause 27? Or does it extend to termination arising from any of the other events listed in clause 27 – for example, failing to proceed regularly and diligently with the works. If the reasoning of Lord Hoffman is followed, then it might well.

Key Points

- Clause 27 of JCT'98 regulates payment post termination. The issue is whether it is a scheme of withholding, which is prohibited by section 111(1) of the Housing Grants etc Act?
- The House of Lords held that it is not: section 111(1) was never intended to deal with the situation of an employer wishing to exercise his rights of set-off following termination (on the grounds of insolvency) under clause 27.
- The question now is how far that decision extends – do the same principles apply on termination for reasons other than insolvency ?

This article is correct to the best of our knowledge and belief at the time of going to press. It is however written as a general guide, so it is recommended that specific professional advice is sought before any action is taken. We are required by law to protect personal data.

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