IN THE HIGH COURT OF THE REPUBLIC OF SINGAPORE

[1997] SGHC 297

Suit 821/1996

Between

Interpro Engineering Pte Ltd

… *Plaintiff*

And

Sin Heng Construction Co Pte Ltd

… *Defendant*

GROUNDS OF DECISION

Building and Construction Law; Contract — Contractual terms — Rules of construction

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Interpro Engineering Pte Ltd v Sin Heng Construction Co Pte Ltd

[1997] SGHC 297

Suit 821/1996
Choo Han Teck JC
14 November 1997

1 **Judgment:**

2 **CHOO HAN TECK JC**

3 This is a building contract claim for payment for work done by the plaintiffs under a sub-contract with the defendants dated 10 November 1992. The defendants were themselves the sub-contractors to Tavica Development Pte Ltd (Tavica). Tavica was employed by Empire Electronics Pte Ltd (owners) to construct a factory at Yishun Industrial Park A. The shareholders and directors of Tavica were also the directors and shareholders of the owners.

4 2.The defendants agreed with Tavica that it will build the said factory at its own cost in consideration of a sum of $7,025,000 as well as any sum due in respect of variation or additional works.

5 3.In turn, the defendants` contract with the plaintiffs provided, in cl 2, that:

> *The only total profit which [the defendants] shall be entitled to retain or make out of the contract shall be 5% of the builder`s work of $4,650,000 and the [plaintiffs] shall be entitled to keep the remaining profit or shall bear the whole of any loss which may be made or incurred in the execution of the said works under the contract, which said profit is to be paid by [the plaintiffs] to [the defendants] in the manner as described in cl 7 below.*

6 Clause 7 referred to above provides as follows:

> (i) As and when a progress payment for main contractors work is received by [the defendants] from [Tavica], [the defendants] shall promptly cause it to be banked into [the defendant`s] bank account and shall immediately upon its clearance issue a cheque in [the plaintiffs`] favour in the same sum as the progress payment received less 5% and any materials ordered on [the plaintiffs`] behalf thereof (hereinafter called the `net sum`).
>
> (ii) [The plaintiffs`] entitlement to payment of the net sum each time shall arise progressively as and when a progress payment or NSC sum including the retention sum, is received from Tavica by [the defendants] and [the plaintiffs] shall issue an official receipt to [the defendants] for each and every payment received.

7 4.The plaintiffs commenced work in November 1992 and completed the work in December 1993 the same month the owners took over possession of the factory. The architect certified payment of $4,859,277.82 from Tavica to the defendants. The defendants have received a sum of $4,692,795.87 from Tavica and in turn paid a sum of $4,427,406.14 to the plaintiffs (after retaining $232,500 being 5% of the contract sum of $4,650,000). The above facts are not in dispute. The defendants have commenced action in Suit No 1178/97 against Tavica in respect of the balance unpaid by Tavica to them. That action is pending.

8 5.The plaintiffs` claim in this action against the defendants is for the balance outstanding under their sub-contract. The amount claimed is virtually

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the same as that claimed by the defendants against Tavica. The amount stated in the very brief statement of claim is $269,935.08, but the parties have since narrowed the figure, and subject to the determination of the issues of construction, the amount due is not disputed.

9 6.There are only two issues in this suit. First, are the defendants entitled to 5% of the amount of $4,650,000 as stated in cl 2 of the contract between the plaintiffs and the defendants, or are they entitled to 5% of the total due under the architect`s certificate, namely, $4,859,277.82? The second issue is, whether the defendants are obliged to pay only when they themselves had been paid by Tavica. Depending on the court`s finding in respect of the first issue, the parties have agreed that the amount due from the defendants to the plaintiffs is either $168,622.28, or $158,157.85.

10 7.The stated issues are questions of construction of the terms of the contract. The essential facts as I have set out above are not disputed. I now deal with the first issue which is a relatively straightforward one. It concerns the interpretation of cl 2 as set out above. On a literal reading of this term it is clear that the defendants agreed to accept 5% of $4,650,000 as the `total and only profit` which they should receive. There is no reference to an entitlement of a percentage of payment in respect of variation or additional works even though such works were contemplated in the contract. There is no reason to deviate from the literal interpretation of the words in this clause. The literal interpretation rule is the first rule to be applied in any case unless there are grounds to indicate that an application of that rule will not yield any sensible meaning, or may lead to some absurd result which neither party could have intended. In this case, the parties agreed that the plaintiffs are `entitled to keep the remaining profit`, and to bear any loss. It seems to me quite clearly that by cl 2 the parties had agreed that the defendants get to keep 5% of the stated

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$4,650,000 and the plaintiffs get to keep the balance and any excess profit, and if they had built the factory at a loss they (the plaintiffs) will bear that loss. The phrase `remaining profit` is not the same as `the remainder` or `the balance of the $4,650,000`. `Remaining profits` in the present context must mean whatever profit remains, including profit from variation or additional works, if any. There is, therefore, no room to argue that the 5% should include profit from additional or variation works.

11 8.The second question is whether cl 7 of the contract is a `pay when paid` clause, and if so, what is the effect of that clause in this case. The defendants contend that by virtue of this clause they are not obliged to pay the plaintiffs any sum unless they have themselves been paid by Tavica. Counsel for the defendants referred and relied on **Brightside Mechanical & Electrical Services Group Ltd & Anor v Hyundai Engineering & Construction Co Ltd** [1988] SLR 186 , which in turn refers to two Hong Kong cases, namely, **Hong Kong Teakwood Works Ltd v Shui On Construction Co Ltd** [1984] HKLR 235, and **Schindler Lifts v Shui On Construction** [1985] HKLR 118[1985] 2 HKC 735 for the proposition that clauses such as cl 7 in this case (those cases have similar, but differently worded clauses) must be given a literal meaning. The courts in these cases were inclined to that view, but as LP Thean J (as he then was) said in the ***Brightside*** case, the views expressed by himself and the Hong Kong judges were only provisional views as they were dealing with the matter at the summary judgment proceedings only, and it remained for the trial judge or arbitrator to come to the final definitive opinion. It appears that after the summary judgment proceedings the matters in Hong Kong as well as here did not advance any further and there are no reports of the final decisions at trial. It may be useful to compare the ***Brightside*** clause with cl 7 above. The former, as set out in the judgment of LP Thean J, is as follows:

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> 11(b) Within five days of the receipt by the contractor of the sum included in any certificate of the architect the contractor shall notify and pay to the subcontractor the total value certified therein in respect of the subcontract works and in respect of any authorized variations thereof and in respect of any amounts ascertained under cl 8(c) hereof less:

12 9.The main argument of the plaintiffs is that cl 7 does not expressly say that the defendants` obligation to pay the plaintiffs is conditional upon their being paid by Tavica, or that if no payment is received by the defendants the plaintiffs are not entitled to be paid. Their counsel submitted that cl 7 `merely provides for the defendants to become a sort of trustee for moneys received, being held for the benefit of the plaintiffs`. That would be reading too much into the contract, but I accept that such clauses, indeed all contractual clauses, must be explicit and unambiguous. Clause 7(ii) appears to me reasonably straightforward and unambiguous. The plain meaning is that the plaintiffs are not entitled to any progress payments unless such payments are received by the defendants from Tavica. The result of such a reading is obvious, but some writers have expressed misgivings in construing the phrase `receipt of payment` too narrowly. In ***Emsden`s Construction Law*** (1997 Ed) at para 812, the editors made the following comments:

> *A number of cases in Hong Kong and Singapore have raised the question of the sub-contractor`s rights to payment when payment to the main contractor is withheld by the employer, and the sub-contract contains a provision to the effect that payment to the sub-contractor is dependent on receipt by the main contractor of payment in respect of the sub-contractor`s work from the employer. The effect of these decisions is that when the employer sets off against payment due the main contractor a cross-claim for delay, the main contractor is not treated as having received payment, and so is entitled to withhold payment from the sub-contractor. These decisions have been criticised on three grounds; firstly, they give the notion of `receipt` of money an unduly narrow meaning, requiring an actual transfer of funds rather than including a settlement by way of set-off, which would normally be sufficient to establish payment. Secondly, it seems*

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> *doubtful whether the contractor`s right to withhold payment should be exercisable when payment is in turn withheld by the employer on the basis of a matter which is not the fault of the sub-contractor. This is almost equivalent to allowing a party to take advantage of his own wrong. Thirdly, these decisions seem to overlook the requirements under the relevant form of contract (modeled on NFBTE/FASS form of sub-contract for when sub-contractor is nominated under the 1963 JCT form of contract) to the effect that the certificate of the architect under cl 8(a) of the sub-contract is a condition precedent to the main contractor`s right to claim loss or damage from the sub-contractor for delay.*

13 10.I do not propose to address these concerns specifically save to say that they appear to be overly sensitive to the unpaid sub-contractor who, in such cases, is probably the innocent party in a building project gone awry. While the courts will readily wrap a caring arm around the weak and the meek, they cannot do so in every instance. Everyone negotiates his own contract. He is at liberty to give and take as much as he can mutually agree with the other side. The sub-contractor per se is not a special species which requires special principles of law to give him a generous dose of legal protection.

14 11.There are some authority, mainly from the United States of America, such as **Pacific Lining Co Inc v Algernon-Blair Construction Co** [1987] 819 F 2d 602 which took the strong view that `pay when paid` clauses merely have to do with the time of payment, and, therefore, do not prevent a sub-contractor from being paid even though the main contractor had not been paid because of the bankruptcy of the owner. Unfortunately, this was not a reasoned judgment and does not provide much assistance. The other cases seem to be based on the desire to protect the interests of the out-of-pocket sub-contractor. This approach ignores the interests of the main contractor, the freedom of contract, and the fact that contracts may differ from case to case. A `pay when paid` clause in one contract may be worded differently from another.

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15 12.The apparent injustice which may arise in some cases is recognised in **Iezzi Construction Pty Ltd v Watkins Pacific (Qld) Pty Ltd** [1995] 2 Qd R 350 at p 361. McPherson JA said at p 359:

> *Clause 10(d) provides that the plaintiff`s right as sub-contractor is dependent on the third defendant builder`s having actually received from the proprietor payment in respect of the sub-contractor`s claim, `and that sub-contractor shall have no other or further right to payment`. Viewed in isolation from the remainder of the clause, cl 10(d) is literally wide enough to cover payments of any kind whether they are progress or final payments. There are, however, several matters that persuade me that cl 10 and in particular cl 10(d) must be more narrowly confined.*
>
> *One is the character and effect of cl 10(d). A contract is illusory and void if the right to payment or performance is made to depend on the will of one of the parties to it:* ***Thorby v Goldberg*** *[1964] 112 CLR 597; but not if it is postponed to the happening of some external event such as payment or performance by a third party:* ***Barnett v Ira Birk Pty Ltd*** *[1952] 52 SR (NSW) 268. Nevertheless, the particular disadvantage to which the plaintiff would be exposed in a case like this is that if the proprietor does not pay the builder, the plaintiff would have done the work for nothing. That means it must be taken as having contracted to work not for the contract sum agreed in cl 2(iii) of this contract but for no more than the hope or chance of being paid that sum. A contract in those terms is enforceable; but it is not to be assumed that the parties intended that result unless the words used plainly require such a conclusion.*

16 13.The majority in the ***Iezzi*** case found that the clause in question appears to restrict the main import of the clause to progress payments only and not to the final payment, and the plaintiff there was thus able to recover for work completed. Clause 7 in the present case is quite different in this respect from the ***Iezzi*** clause.

17 14.Some textbook authorities such as ***Hudson`s Building and Engineering Contracts*** (1995 Ed) have likened the relationship established between the main contractor and sub-contractor to that of a joint venture partnership by virtue of a `pay when paid` clause. That is a fair way of looking

at it, but it is not likely that these parties would normally intend to form a joint venture partnership as such. It is only so far as the reward of profit is concerned that they may agree that they will both share in the risk of the employer not making payment. They may thus, by clear words express their common intent.

18 15.In the present case, I cannot see how any other meaning can be given to such a simple phrase as `entitlement to payment` other than the right to be paid. There must be strong reasons why it should be given a wider meaning and I can find none in the present context. Unlike the ***Iezzi*** clause, the clause in this present case makes no reference to any payment other than progress payment. While this may appear to invite the application of the ***expressio unius est exclusio alterius*** rule of interpretation, and thus leads to the conclusion that it does not apply to final payment, I am not inclined to think it necessary to apply that maxim. Otherwise, (if one also accepts the ***Iezzi*** approach) it will mean that whether or not the clause makes reference to a payment other than progress payment the conclusion would be the same. I would prefer to read the clause as it is, and if a clear meaning comes through without the need to rely on any specific tool of interpretation, then that is the meaning the parties must have intended.

19 16.Clauses such as cl 7 are common industry clauses which must be accepted by the parties with the knowledge of the attendant risks. The problem arises only when the employer fails to pay the main contractor. There are at least four general situations which may give rise to some problems. First, the employer may become insolvent. In such a case, neither the main contractor nor the sub-contractor is at fault, and if the main contractor has not received any payment, the sub-contractor too gets nothing. The main contractor and the sub-contractor will have to bear the loss, probably in different proportions. If the main contractor pays his sub-contractor he suffers the loss by himself. If he does

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not pay his sub-contractor, both he and his subcontractor will suffer the loss of not being paid. There is no reason why the main contractor and sub-contractor cannot agree between themselves that in such situations neither party should be better of than the other or apportion the risk of loss as they think just. They are entitled to agree that one gets paid only when the other is paid. This is merely a recognition of the risk of insolvency of the employer and the parties` own acceptance that in such event, the main contractor should not be the one to bear all the loss. The vulnerability of the sub-contractor in such a case is a risk arising from the freedom to contract. It is the same risk, but of a lesser degree that the main contractor is also exposed to. It behoves each of them to protect their own interests with well-crafted provisions.

20 17.Secondly, where the employer is not insolvent, but the main contractor neglects to collect payments due, the court may imply a term in the contract that he will make reasonable efforts to collect payment. This is no more than what an officious bystander would have thought. It may, however, be prudent for the parties to incorporate such a term in the contract itself rather than to rely on an implied term. In the present case, the defendants had, in fact, commenced proceedings in a writ action against Tavica. That action was commenced late, and it is still pending. Hence, as at the time of this trial, they have acted reasonably in making the necessary attempts to collect payment from Tavica.

21 18.Thirdly, where the main contractor has wrongfully repudiated the contract with the sub-contractor the latter is entitled to sue for damages, or recover on a quantum meruit basis. In the ***Iezzi*** case MacPherson JA seems to think that a claim on a quantum meruit basis would be more appropriate since the contract between a main contractor and sub-contractor incorporating a `pay

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when paid` clause is not a bargain for payment of the contract sum but merely a hope of being paid that sum.

22 19.The most difficult situation concerns instances in which the owner or employer seeks to set-off payments due to the main contractor against some alleged debt owing by the latter to him. In such cases, the sub-contractor is clearly an innocent party who would have done the work and is not being paid even though the employer is solvent. It is up to the parties to provide expressly in the contract, if they so wished, that the main contractor shall assume responsibility for payment to the sub-contractor in this sort of event. In the absence of such express provisions the sub-contractor runs the risk that a plain reading of the `pay when paid` clause in their contract leaves him with no remedy. This sort of situation is similar to that where payment is dependent on the certification of a third party who, for one reason or another, refuses or fails to certify.

23 20.For the reasons above, I find that in this case the defendants are entitled only to 5% of the sum of $4,650,000. The excess amount of $2,140.33 collected by them from Tavica must be paid over to the plaintiffs. In respect of the second issue, I find that the plaintiffs are not entitled to payment of the balance due until the defendants have been paid by Tavica. The parties have made a prior agreement that, inter alia, there will be no order as to costs in this action.

Choo Han Teck JC

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