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Sub-contract - claim for payment for work done - effect of 'pay when paid' clause - whether effective to prevent plaintiffs from being paid until defendants received payment from other party

Interpro Engineering Pte Ltd v Sin Heng Construction Co Pte Ltd [1998] 1 SLR 694

The plaintiffs were sub-contractors of the defendants claiming for work done under the sub-contract dated 10 November 1992. The defendants were themselves the subcontractors 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.

Clause 2 of the sub-contract between the defendants and the plaintiffs provided that the only profit which the defendants were entitled to make out of the contract was "5% of the builder's work of $4,650,000" and the plaintiffs were entitled to keep the "remaining profit" or bear any loss which arose under the contract. Clause 7, the "pay when paid" clause, provided that when a progress payment was received by the defendants from Tavica, the defendants were to make payment to the plaintiffs of such sum less 5% and any materials ordered on the plaintiffs' behalf. It was provided that the plaintiffs' entitlement to receive such payment arose "progressively as and when a progress payment [was] received from Tavica by [the defendants]".

The plaintiffs commenced work in November 1992 and completed work in December 1993. The architect certified payment of $4,859,277.82 from Tavica to the defendants. The defendants 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 plaintiffs claimed the balance outstanding under their sub-contract. The amount due was not disputed.

One of the issues was whether the defendants were obliged to pay only when they themselves had been paid by Tavica. On this issue, the court held, giving full effect to clause 7, that its plain meaning was that the plaintiffs were not entitled to any progress payments unless such payments were received by the defendants from Tavica. In arriving at this decision, the court had the following to say:

> *"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."*

The court also noted that "clauses such as clause 7 are common industry clauses which must be accepted by the parties with the knowledge of the attendant risks." The court observed that the problem arises only when the employer fails to pay the main contractor and that the various situations can be categorised as follows. First, if it is due to the insolvency of the employer, then it appears that the sub-contractor shares in the main contractor's risk as regards payment by the employer. Second, where 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. Third, where the main contractor has wrongfully repudiated the contract with the subcontractor the latter is entitled to sue for damages, or recover on a quantum meruit basis. Fourth, in the situation where the owner or employer seeks to set-off payments due to the main contractor against some alleged debt owing by the latter to him, the subcontractor, who may be an innocent party who would have done the work and is not being paid even though the employer is solvent, runs the risk that a plain reading of the "pay when paid" clause in their contract leaves him with no remedy.

EDITORIAL COMMENT

This is the most recent of a series of cases dealing with "pay when paid clauses." Generally, such a clause provides that the sub-contractor is only entitled to be paid when the main contractor has himself received payment. When such a provision is inserted in the sub-contract, it is usually not enough that the payments have been certified, but not received yet by the main contractor. It may not even matter whether the payment has been withheld from the main contractor by the employer due to the main contractor's own default or breach and the default or breach was not caused or contributed to by the sub-contractor. Such clauses were first considered in some detail in Singapore in Brightside M&E Services Group v Hyundai Engineering & Construction (1988) 1MLJ 500 which followed the Hong Kong decisions of Schindler Lifts (HK) Ltd v Shui On Construction Co Ltd (1984) 29 BLR 95 and HongKong Teakwood Works Ltd v Shui On Construction Co Ltd [1984] HKLR 235.

In the Brightside case, the sub-contractor carried out mechanical engineering works under a sub-contract that provided that "within 5 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 sub-contractor the total value certified therein." The architect certified a sum of $1.6 million as being due to the plaintiffs which after taking into account deductions that were allowable became $925,000. By reason of delays in the completion, the employers refused to make further payment to the main contractor raising a set-off based on a claim for liquidated damages. The main contractor in turn refused to pay the sum of $925,000 to the sub-contractor citing the above "pay when paid" clause and argued that they were not obliged to pay the sub-contractor as they had not received any money from the employer. Thean J (as he then was) held that the clause contemplated actual receipt by the main contractor of the sum included in the certificate and decided in the main contractor's favour.

It therefore appears that both the Singapore and Hong Kong courts adopted a literal approach to "pay when paid" provisions that is not favoured, if not criticised, in some academic quarters. The court in the Interpro case, in fact, addressed these concerns as follows:

> "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 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."

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