

## Insights

# DOES “BACK TO BACK” MEAN “PAY WHEN PAID” IN CONSTRUCTION CONTRACTS?

HK COURT OF APPEAL GIVES GUIDANCE

Apr 29, 2025

## SUMMARY

In *Sze Fung Engineering Limited v Trevi Construction Company Limited* [2025] HKCA 278<sup>[1]</sup>, the Hong Kong Court of Appeal (“CA”) ruled that the “back to back” wording in that case was not a “pay when paid” clause, but governed only the timing of payment.

## BACKGROUND

These proceedings arose out of a construction project to build a new combined gas turbine unit. The plaintiff was a sub-sub-contractor (“SSC”) and the defendant was the sub-contractor (“SC”). It was common ground between the parties that the quotation submitted by the SSC to the SC formed part of the sub-sub-contract between the parties.

Item 18 of the quotation provided that:

*“Payment is based on ‘back to back’ principle and to be released to [SCC] within 3 days upon receipt of the same from Client.”*

After the SCC commenced its works, the SC sent to the SCC a draft contract, which contained a “pay when paid” clause. The SCC declined to agree to the draft contract because the works had commenced and a binding contract between the parties (including the terms in the quotation) had been agreed.

## CFI FIRST INSTANCE JUDGMENT

In the judgment given by the Court of First Instance (“CFI”), one of the decisions that the judge made was that item 18 of the quotation was a “pay when paid” clause, in that payment to the SCC was to be made by the SCC back-to-back to the SC being paid by the main contractor, and that

payment to the SCC would be released within three days upon the SC's receipt of payment from the main contractor. The CFI was of the opinion that it was artificial to draw a distinction between the "time" for payment and "liability" for payment, because "liability" involved the same question as to when such liability arose.

## CA'S JUDGMENT

In allowing the appeal against the decision of the Court of First Instance, the CA considered the following factors:

1. The wording "back to back" was not a term of art but an ambiguous term. It can mean that the timing of payment to the SCC should follow the payment received by the SC. It also can mean that apart from the timing of payment, the SCC's entitlement to payment was dependent or conditional upon the SCC being paid.
2. Drawing a distinction between "timing" of payment and "entitlement" to payment, the CA stated that an "entitlement" to contractual payment should not be lightly disturbed by the imposition of condition in the absence of clear words. Where the wording is ambiguous (as in this present case), the court must look for adequate support before coming to the interpretation that both timing and entitlement were governed by the same term.
3. The factual matrix in the present case did not support the interpretation that item 18 was a "pay when paid" clause. The proper interpretation of item 18 was that the "back to back" wording governed the timing of the payment.
4. It would be contrary to commercial sense to interpret item 18 as a "pay when paid" clause. If item 18 was a "pay when paid" clause, the SCC would never be paid for works that did not form part of the scope in the sub-contract between the SC and the main contractor, but which were included within the scope of the sub-sub-contract between the SCC and the SC<sup>[2]</sup>.
5. The CFI had taken into consideration, when interpreting item 18, certain subsequent conduct of the parties. In doing so, the CFI relied on one of the exceptions to the general rule that post-contract actions are inadmissible, namely *"to show whether there was a contract and what the terms of the contract were"*. The CA was of the opinion that there was no issue between the parties that item 18 was part of the sub-sub-contract, and therefore that the real dispute was whether item 18 was, on proper interpretation, a "pay when paid" clause. The CA therefore decided that subsequent conduct of the parties should be ignored in the interpretation exercise.

## CONCLUSION

This case is a reminder of the legal risks that parties may face if contractual provisions are drafted ambiguously. This is especially so where a party wishes to rely on an ambiguous term to affect

important contractual entitlements of the other party, for example the entitlement to contractual payments.

As we have covered in an earlier Insight, all conditional payment provisions (including “pay when paid” provisions) will be prohibited under the Construction Industry Security of Payment Ordinance (Cap 652), which applies to contracts entered into on or after 28 August 2025. The “back to back” provision in this present case, which imposed a condition on the payment date (i.e. the SC to pay the SCC within three days after the SC is paid) also will be unenforceable under this legislation.

However, “pay when paid” clauses remain legal and enforceable if they are contained in contracts entered into before 28 August 2025, provided that they are properly drafted and unambiguous.

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[1] Date of Decision: 28 March 2025

[2] The scope of works between the sub-contract and the sub-sub-contract was not identical.

## **RELATED PRACTICE AREAS**

- Litigation & Dispute Resolution
- Business & Commercial Disputes
- International Arbitration

## MEET THE TEAM



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