

# LEGAL UPDATE

A DREW &amp; NAPIER PUBLICATION

## CASE UPDATE

### THE IMPORTANCE OF DRAWING UP FORMAL CONTRACTS

*City Ken Pte Ltd v Comfortdelgro Engineering Pte Ltd* [2010] SGHC 29

#### Executive summary

This case illustrates why it is always better to have formal contracts to document business arrangements even when parties have had a good prior working relationship.

**Indraneel Rajah, SC, Rakesh Kirpalani** and **Samuel Lee** of Drew & Napier LLC acted for the successful defendants.

#### Facts

Comfortdelgro Engineering Pte Ltd (the "**Defendants**") were appointed by CityCab Pte Ltd ("**CityCab**") to repair CityCab taxis which had been involved in accidents with third party motor vehicles. The Defendants sub-contracted the repair work to City Ken Pte Ltd (the "**Plaintiffs**"). The Plaintiffs and the Defendants had had a long standing prior commercial relationship. In 1997, the Plaintiffs and the Defendants entered into a profit-sharing arrangement (the "**Agreement**") for the repair work but did not document the arrangement through any formal contracts.

The Defendants paid the Plaintiffs' repair costs upfront. The Defendants would then, on behalf of CityCab, seek to recover the repair costs from the third party drivers or their insurers. The Plaintiffs and Defendants were to share the recovered repair costs in an 80:20 proportion.

Since the Defendants had paid the Plaintiffs their share of the repair costs upfront, if the full repair costs could not be recovered from the third parties at the end of the day, the Defendants were entitled to a refund or clawback from the Plaintiffs in the same 80:20 proportion. The clawbacks were reflected in debit notes issued by the Defendants (the "**Debit Notes**"). The Debit Notes were set off against other invoices raised by the Plaintiffs in a running account.

In 2006, the Plaintiffs commenced an action against the Defendants alleging, amongst other things, that:

- (a) the Defendants had, since 2002, wrongfully issued Debit Notes in breach of an implied term that the Defendants would consult and obtain the Plaintiffs' approval prior to any settlement with the third parties. The Plaintiffs also complained that the Debit Notes were invalid as they lacked particulars and the Plaintiffs could not ascertain which repair claims they related to; and

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- (b) the Defendants had been negligent in their settling of the claims vis-à-vis the third parties or their insurers.

### **The High Court's decision**

The Plaintiffs' action was dismissed in its entirety.

#### *Implied terms regarding handling of the claims and settlements*

The court held that there was no implied term that the Defendants were to consult and seek the Plaintiffs' approval on settlements. The court held that the two tests for the implication of implied terms, ie. the officious bystander test and business efficacy test, were complementary tests and both would apply to business contracts.

In this case, the Plaintiffs' approval was not necessary to give business efficacy to the Agreement. On the contrary, such a requirement could be abused by the Plaintiffs, who could withhold their approval for settlements to avoid making clawback payments.

While it was not unreasonable for the Plaintiffs to want to be consulted, they had failed to insist on an express term for this in the Agreement. The court was unable to imply such a term into the Agreement, particularly since there was an implied term that the Defendants were to use reasonable care and due diligence in settling the claims (see below).

#### *Validity of the Debit Notes*

The court had to review the parties' operating procedure and documentation over a 10 year period in order to deduce what knowledge and information the parties possessed at the material time.

The court found that while the Debit Notes did not on the face of them contain the particulars of the vehicles and repairs they related to, these particulars were contained in the claim files which were handed to the Plaintiffs together with the Debit Notes. Therefore, at all material times, the Plaintiffs would have been aware of which repairs and vehicles the Debit Notes related to. The fact that the Plaintiffs were aware of the Debit Notes was also reflected in their own statements of accounts.

#### *The allegation of negligence*

The court agreed that it was an implied term that the Defendants should use reasonable efforts and diligence but held that the Plaintiffs had failed to prove its allegation that the Defendants had acted negligently in settling the claims with the third parties and their insurers.

The court noted that the Plaintiffs had asserted negligence even before they had inspected the claim files. In support of its negligence claim, the Plaintiffs relied on the investigation report of its own employee. The court felt the investigation should have been conducted by

an independent person rather than the Plaintiffs' own employee. The process by which the files were selected for inspection was also unsatisfactory.

### Comment

One of the main reasons why there was no formal documentation of the contractual arrangement was because in the early days, the parties had a good working relationship and it was not felt that there was a need for formal documentation. However, over time, different people took over various functions and there were differences in positions as to the contractual intention, which led to the dispute. This case reinforces the need for clear contractual documentation even between friendly parties.

If you would like more information about this case or wish to discuss how it may potentially affect you or your business, please feel free to contact the litigation and dispute resolution lawyers in Drew & Napier LLC (please refer to the Directors' profiles on our [website](#)), or:

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