

## Your Contractual Questions Answered

# Is Late Payment A Ground For Determination Or Termination?

By The Entrusty Group

**Entrusty Group, a multi-disciplinary group of companies, of which, one of their specialisation is in project, commercial and contractual management, has been running a regular contractual questions and answers section for Master Builders members in the Master Builders Journal.**

**In this instalment of this series, Entrusty Group will provide the answer to another frequently asked question above.**

**W**e often hear cash flow is the lifeblood of the construction industry. Yet, late payment is an endemic feature and a root cause of many problems and disputes in the construction industry in Malaysia.

In the previous issue of Master Builders Journal, we have explained the difference between determination of employment and termination of contract, together with their respective implications. In this article, we will look into the situation where the innocent party, usually the Contractor, who contemplates whether to elect to determine its own employment or to terminate the contract when the guilty party, usually the Employer, fails to honour the Contractor's payment within the stipulated period in the contract.

This article aims to provide an understanding of the Contractor's rights and remedies on non or part payment, and the circumstances and conditions for determination of its own employment or termination of the contract, where applicable.

Let's us first review the relevant clauses on payment and determination of employment by the Contractor under the standard forms of construction contract commonly

used in the Malaysian construction industry before we move on to the common law termination.

### Standard Forms of Construction Contract

#### • Certificates relating to payment

Most of the standard forms of construction contract in Malaysia require the Employer to pay the Contractor within the stipulated period upon receipt of the amount due as stated in the certificate issued by the Architect/Engineer/SO/PO. There are generally three main types of certificate relating to payment that entitle the Contractor to payment by the Employer, namely Interim Certificate, Penultimate Certificate and Final Certificate. *Table 1* shows the relevant clauses in the standard

forms of construction contract relating to such certificates.

#### • Determination of Employment by Contractor

The majority of standard forms of construction contract, except JKR forms of contract i.e. JKR 203A and JKR DB/T, allow the Contractor to determine his own employment upon the Employer failing or neglecting to make payment on the amount due in the certificate. *Table 2* indicates the relevant contract clauses for the determination of employment by the Contractor for payment default.

#### • Suspension of Works and Interest Charge

Most standard forms of construction contract provision on Employer's

**Table 1 - Certificates relating to payment under the relevant clauses of the standard forms of construction contract in Malaysia**

Payment Certificate	Relevant Contract Clauses					
	PAM 2006	PAM 1998	JKR 203A	JKR DB/T	IEM 1989	CIDB 2000
Interim Certificate	30.1	30.2	47 (d)	50.3 (c)	47 (d)	42.9
Penultimate Certificate	30.13	30.6	-	-	-	42.6
Final Certificate	30.15	30.7 (iii)	48 (c)	51.2	48 (c)	42.8 (f)

**Table 2 - Determination of employment by the Contractor under the relevant contract clauses of the standard forms of construction contract in Malaysia**

Employer's defaults	Relevant Contract Clauses					
	PAM 2006	PAM 1998	JKR 203A	JKR DB/T	IEM 1989	CIDB 2000
Failure to pay	26.1 (a)	26.1 (i)	-	-	52 (a) (i)	45.1 (a) (i)

**Table 3 - Relevant provisions for suspension of works and interest charge due to the Employer's default in payment in the standard forms of construction contract in Malaysia**

Brief Description	Relevant Contract Clauses					
	PAM 2006	PAM 1998	JKR 203A	JKR DB/T	IEM 1989	CIDB 2000
Suspension of works	30.7	-	-	-	-	42.10
Interest charge	30.17	-	-	-	-	42.9 (b)

default in payment, stipulate that the Contractor can either continue with his work or determine his own employment upon default in payment by the Employer. In addition, PAM 2006 and CIDB 2000 allow the Contractor to suspend the works and/or claim interest for the unpaid amount. *Table 3* indicates the relevant contract clauses for the suspension of works and interest charge for such default.

### Common Law Termination

In the previous article, we have explained the word 'determination', in the context of construction contract, is about bringing to an end the Contractor's employment under a particular contract whereby the Contractor's obligation and responsibility to carry out the works under the contract is terminated and not the contract. Therefore, the Contractor's rights and remedies under the contract and at common law are preserved.

The termination of contract at common law occurs when a valid and enforceable contract is brought to an end either by becoming impossible to perform due to unforeseeable circumstances at the time the

contract was formed or by the actions of one or both parties. In order for a contract to be terminated, one party must be in repudiatory breach that goes to the root of the contract and the innocent party accepts such repudiation by rescinding the contract thereby excusing the latter from further performance. Repudiation entitles the innocent party to damages as provided and illustrated in Section 40 of the Contracts Act 1950.

### Late payment: Is it a ground for determination or termination?

Now back to the question whether late payment is a ground for determination or termination. In order to answer that, let us consider five scenarios usually faced by Contractor pertinent to payment upon issuance of Interim Certificate, namely:-

- (1) **Partial payment** – When the Employer makes only partial payment/s on the amount due in the certificate;
- (2) **Late payment** – When the Employer makes payment after the stipulated period for honouring payment;
- (3) **Persistent irregular payment** – When the Employer persistently

over a time, makes either partial payment or late payment or both;

(4) **Unlawful or wrongful deduction of payment** – When the Employer unlawfully or wrongfully deducts any amount due in the certificate; and

(5) **Improperly withholding payment due** – When the Employer improperly, usually not in accordance with the Contract withholds any payment due to the Contractor;

Any of the above scenarios committed by the Employer can be considered as breach of contract for failure to pay accordingly but not all of them amount to repudiatory breach. So, on what circumstances does the Employer commit repudiatory breach which can result in the Contractor having to rescind the contract i.e. to terminate?

*Keating on Building Contracts (6<sup>th</sup> edition 1995, p 156)* explained that when one party breaches the contract, the other party can elect to put an end to it by these two circumstances:-

(1) *where the contracting parties have agreed, whether by express words or implication of law that any breach of the contractual term in question shall entitle the other party to elect to put an end to all remaining primary obligations of both parties, i.e. where there is a breach of condition;*

(2) *where the event resulting from the breach of contract has the effect of depriving the other party of substantially the whole benefit which was the intention of the parties that he should obtain from the contract, i.e. where there is a fundamental breach.*

### Breach of condition

Most construction contracts provision on payment requires the Employer to pay the Contractor the amount due on the certificate within a stipulated period. Any breach of such provision is a breach of

condition by the Employer which entitles the Contractor to exercise his rights and remedies as spelt out in the relevant contract provision i.e. determination of employment by the Contractor. In PAM 2006 and CIDB 2000, the Contractor can suspend the works and/or claim interest for the unpaid amount if he elects not to determinate his own employment.

In the case of late payment, if it is a merely late payment in one payment certificate, although it is a breach of condition by the Employer, the Contractor normally will not elect to take such drastic action to determinate his own employment due to commercial interest and the serious contractual and legal implications. However, if the late payment is persistent or the Employer has no intention to pay accordingly or at all, the Contractor may be forced to take such drastic action. Where there is a dispute or difference on this matter, then the aggrieved party can refer to mediation or arbitration, as provided under most forms of construction contract.

However, in JKR forms of contract i.e. JKR 203A and JKR DB/T, the Contractor is not allowed to determine his own employment or suspend the works or claim interest for the unpaid amount. The Contractor's rights and remedies for this breach under the contract would be to refer to the SO/PD for his decision and if it is still unresolved, then the Contractor may end up having to refer to arbitration for redress and resolution. Alternatively, the Contractor may pursue to seek redress by bringing the matter to the court without rescinding the contract and go for summary judgement under Order 14 or to rescind the contract and sue for damages.

## Fundamental breach

Fundamental breach occurs when the Employer has committed repudiatory breach by refusing to

fulfil his contractual obligations, thereby substantially depriving the Contractor the benefit/s intended by the contract. The Contractor may then rescind the contract and sue for damages.

In case of late payment where the contract does not provide for determination, the explicit wordings contained in the terms and conditions of the contract concerning payment and its remedy will be pertinent, particularly whether the time for payment is of essence or not. For an example, where the term of the contract stipulates that the Employer is obliged to pay the Contractor for the amount of work done or where there is intention of both parties to obtain the benefit/s for the work completed within a certain period, failure to pay by the Employer is a fundamental breach which entitles the Contractor to rescind the contract.

In some cases, a failure to pay in one payment due, out of many, or simply late by a few days, may not be sufficient for the Contractor to rescind the contract unless the Contractor can prove that he has substantially completed the work and has suffered substantial losses as consequence of the breach or if it had occurred towards the end of the contract.

Fundamental breach can also occur even though the contract provides for a contractual determination clause. For example, when the Employer persistently fails or refuses to fulfil his contractual obligations despite the Contractor's repeated demands. Then the Contractor can either bring this matter to the court without rescinding the contract and go for summary judgement under Order 14 or rescind the contract and sue for damages.

## Case Law

The following court cases will shed some light on this question as to under what circumstances

late payment is a ground for determination or termination or otherwise.

(1) *Yap Mok Hin v United Malay States Sugar Industries Ltd [1996] 2 MLJ 286*

In this case, the court held that a mere non-payment of a progress payment does not constitute repudiation and it was the contractor who repudiated the contract by abandoning the work.

(2) *Ban Hong Joo Mines Ltd v Chen & Yap Ltd [1969] 2 MLJ 83*

In this case, the court referred to English case, *Freeth v Burr (1873-74), 9 CP 208* in which the learned judge, Keating, J said '*It is not a mere refusal or omission of one of the contracting parties to do something which he ought to do that will justify the other in repudiating the contract; but there must be an absolute refusal to perform his part of the contract. Non-payment is an element.*'

The court held that the Employer was in breach of his obligation by deliberately refusing to pay what was already due by way of fortnightly payments which was an important element for the Contractor to treat the contract as at an end.

(3) *Pembinaan Leow Tuck Chui & Sons Sdn Bhd v Dr Leela's Medical Centre Sdn Bhd [1995] 2 MLJ 57*

In this case, the Contractor was entitled to obtain full payment due in the Penultimate Certificate pending the disputes resolution. The Employer rights to set-off under the PAM 1969 also came before the Federal Court for decision.

The court held that under Clause 30(1), the Contractor shall be entitled to payment for the sum certified upon the expiration of 21 days of the period for honouring interim certificate from the date of presentation to the Employer. The seriousness of the requirement in the contract for honouring an interim certificate was emphasised by Clause 26.1(1)(a) which allowed

the Contractor to determine his employment or to suspend works if the Employer does not pay the sum certified, and Clause 30(6)(b) allowed for adjustment in the Final Certificate. There were no such provisions requiring the Contractor to execute the works to the satisfaction of the Employer, only the Contractor is obliged to comply with the Architect's instruction. Since there was no such instruction from the Architect for rectification works, the Contractor was under no contractual obligation to comply with the complaints from the Employer.

As for the Employer right to set-off, the court held that there were several expressed provisions in the contract whereby the Employer had the right of set-off but none of them were relevant to the set-off contended by the Employer. By applying the *expression unius* principle, there is a clear implication that, so far as claims for payment on certificates are concerned, the common law right of set-off was to be extinguished. In such circumstances, the court ordered the sum certified in the Penultimate Certificate to be payable to the Contractor.

(4) *Wunsan Sdn Bhd v Luckyhill Mining Sdn Bhd* [1998] 1 LNS 34

The court held in this case that the defendant cannot terminate the agreement since they had already accepted the payment, albeit late, and furthermore the court viewed that it was not the intention of the parties that the agreement can be terminated on breach of non-payment clauses.

## Conclusion

Late payment certainly constitutes a breach of contract and whether it is a ground for determination or termination is very much dependent on the contract provisions and the intention/action of the contracting parties. In common law termination, a mere late payment may not be sufficient for the Contractor to rescind

the contract unless the breach is so serious and fundamental so as to go to the root of the contract, such that the Employer does not intend to or cannot substantially perform his obligations under the contract, then such breach would constitute a repudiatory breach by the Employer.

However, under the circumstances it can be difficult to prove that a late payment in question would amount to a repudiatory breach by the Employer without any expressed term provided in the contract. Consequently, most standard forms of construction contract, expressly provide contractual determination clauses with the rights and remedies for the Contractor upon such determination. However, Contractor must exercise with care and be absolutely sure, otherwise the Contractor can be in a repudiatory breach situation for the Employer to turn around to determine the Contractor's employment, or terminate the contract for repudiatory breach at common law, instead. **(MBJ)**

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In the next issue of the MBAM journal the article will answer the question on **'What Constitute Variations And How To Evaluate Them?'**



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