

What Is The Recent Position On Retention Sums In Malaysia?

By the Entrusty Group

The Entrusty Group, a multi-disciplinary group of companies, of which, one of their specialisations is in project, commercial and contractual management, has been running a regular contractual question-and-answer section for MBAM members in Master Builders Journal.

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

The practice of holding back or setting aside a portion of monies due to the Contractor by the Client (normally referred to as the Employer under construction contracts) is an entrenched practice within the construction industry the world over. This monies held back is referred in the industry as Retention Sum, which is normally stipulated and spelled out clearly as one of the clauses in the condition of contract.

The purpose of such retention sum is to protect the Employer in the event when the Contractor fails or defaults in its performance under the contract, such as abandonment or the works is of poor or defective quality.

The construction contract usually states that this money set aside as Retention Sum is to be kept by the Employer "fiduciary as trustee" for the Contractor.

This basically requires the Employer to set up a trust fund on behalf of the Contractor. A trust fund is basically holding on behalf of another party's monies or property without the right to use or invest the monies or property.

Some of these retention sum clauses further states apart from keeping the money in trust for the Contractor, such retention sum is to be kept in a separate bank account.

In Malaysia, all standard forms of construction contracts have a retention sum requirement apart from the Public Works Department Contract PWD 203/A. Architects' Association of Malaysia (more popularly known as PAM, its Malay acronym) Form of Building Contract has its Retention Sum provision under clause 30.4 and 30.5, similarly the Institution of Engineers Malaysia Civil Engineering Conditions of Contract has its retention

Sum provision under clause 30.3 and 30.4. These two contracts' provision for retention sum are relatively similar where it states that amounts so retained shall be fiduciary as trustee for the Contractor (but without obligation to invest). The monies so retained belong beneficially to the contractor.

The Construction Industry Development Board (CIDB) Form of Contract for Building Works has its retention sum provision under clause 42.3. The CIDB contract goes further to state that the retention sum is to be kept by the Employer in a separate bank account as well as to provide to the Contractor statement of account when making interim payments to the Contractor. Whereas the PAM and IEM contracts are silent as to the retention money held in trust is to be kept in a separate account.

Notwithstanding that the retention sum is held in trust on behalf of the Contractor, all these contracts have the wordings that the "Employer has the right to deduct from such sum due or to become due to the Contractor from payment of any amount he is entitled under the provisions of this Contract, as certified by the Architect" or similar wordings. This means that although the Contractor has the beneficial right to the retention sum, such beneficial right is subject to the Employer's entitlement to draw on such retention sum if the Employer is contractually entitled to do so, as a remedy for defaults of the Contractor under the contract such as defective work.

The retention sum has been the cause for many disputes between the Employer and Contractor. First of these is that the



Employer never set up a trust fund for the retention sum. Secondly, when the time comes for the release of the retention sum, the Employer refuses to release the retention sum; usually citing its right to set-off against monies due from the Contractor for the Contractor's alleged defaults.

So what is the current Malaysian legal position on the requirement for Employer to set up a trust fund and can the Employer set-off against the retention sum held in trust on behalf of the Contractor? The recent cases on retention sum appears to have distinguished the treatment of retention sum before and after the conclusion of the contract or when the contract is terminated / Contractor's employment is determined.

The recent High Court case of *Teh Ah Khoon Enterprise Sdn Bhd v Puncakdana Sdn Bhd* [2005] 2 AMR 52 provides some insights into whether an Employer must set up a separate trust fund to keep the retention sum and whether an Employer is entitled to set-off against such retention sum directly against a claim for liquidated and ascertained damages (LAD). The decision of this case follows the decisions of two pillar cases on retention sum. First is the English Court of Appeal case of *Henry Boot Building v Croydon Hotel & Leisure Co* 36 BLR 41 and the Malaysian High Court case of *LEC Contractors (M) Sdn Bhd v Castle Inn Sdn Bhd* (No 2) [2001] 5 MLJ 510.

The facts of the case is where the Plaintiff, Teh Ah Khoon Enterprise Sdn Bhd is the Contractor and has entered into a contract with the Defendant, Puncakdana Sdn Bhd who is the Employer for the construction of a condominium project under the PAM 98 Contract. After disputes have arisen, the Employer determined the employment of the Contractor and set-off from the retention sum for Liquidated Damages claim against the Contractor for its failure to complete the project on time. The Contractor then applied to the court to have the Employer to keep the retention sum in a separate trust account and restrain the Employer from using the retention sum until the disposal of an on going arbitration proceedings.

The Court held that if the application is made prior to the termination of the



contract, the Court will uphold the application for the Contractor to keep the retention sum in a separate trust account per Clause 30.5(i) of PAM 98. This part of the decision is consistent with the decision of *Rayack Construction Ltd v Lampeter Meat Co Ltd* (1979) 12 BLR 30, where the application in *Rayack* case was made without any termination of contract. However in this case of *Puncakdana* the application is after termination and the Court held that upon termination of the Contract and if there exist a certificate to entitle the Employer to deduct Liquidated Damages that exceeds the retention sum amount, then there is no obligation for the Employer to set up a separate trust account. This echoes the decision of *Henry Boot* where Mr Justice Thomas in refusing to grant an injunction held that:

Although under Clause 30(4)(a) [similar to PAM 98 Clause 30.5(i)] the Employer was

under an obligation to appropriate and set aside amounts retained as a separate trust fund and that obligation could be enforced by the grant of a mandatory injunction, no such injunction could be granted at the time when the employer was entitled to deduct a greater amount of liquidated or ascertained damages because there was no subsisting obligation to appropriate and set aside.....

And the "Commentary" at p 42 of Henry Boot, it was noted as follows:

[The right in the present case referred to above] in effect takes precedence over the obligation to create and set aside a separate trust fund into which the retention money would otherwise be paid. If therefore a certificate is issued under Clause 22 before a separate trust fund has been created, the employer would not be obliged to establish such a trust fund when to do so would be pointless since he would be entitled to have immediate recourse to it to recover the amounts to which he was entitled. Similarly, even where a trust fund has been created, the issue of a certificate under Clause 22 immediately confers on the employer a right to draw from that fund so that he is from that time pro tanto no longer a trustee but a creditor.

(Emphasis added)

It is the same situation with the *Puncakdana* case where the Architect has issued a certificate of non-completion under clause 22 of PAM 98 and the Employer from there on has the right to deduct Liquidated Damages per clause the second part of clause 30.5(i) which



states "....the right of the Employer to have recourse.....for payment of any amount as the Architect may certify.....to deduct from such sum due or become due to the Contractor." The only other procedural requirement is that the Employer has to inform the Contractor in writing if he is to deduct any monies due to the Contractor and provide the reason of such deduction (PAM clause 30.5(ii))

The Puncakdana case followed the decision of Dato' Justice Kadir Musa in the case of *LEC Contractors (M) Sdn Bhd v Castle Inn Sdn Bhd (No.2)* [2001] 5 MLJ 510 where it was held that once the LAD claim exceeded the retention sum, the obligation of the Employer to set aside the retention sum into a separate bank account will cease. The Defendant in such a situation is entitled to deduct the LAD claim without having to set aside the retention sum. What were not answered by the court were whether the court will compel the Employer to set aside the retention sum in a separate trust fund if the amount deductible was less than the retention sum, at least for the remaining amount, and that the Employer cannot use this retained monies held in trust.

Dato' Justice Kadir Musa in the *Castle Inn* case went on to state that "The plaintiff's right [to have the retention sum set aside in a separate account] can only be insisted upon during the life time of the contract and not after it was rescinded. As such, by virtue of s 56 of the Contracts Act 1950, the defendant cannot be ordered mandatory to fulfil his "obligation" of setting aside the required Retention Sum after..... the material date when the plaintiff rescinded the contract. What would be most probably justifiable for the plaintiff, if it can be so proved, is to claim compensation for damages for the defendant's non-fulfilment of their "obligation" under the contract by virtue of s 76 of the Contracts Act 1950."

Conclusion

From this Puncakdana and Castle Inn cases, Contractors must be aware of the current Malaysian position on retention sum which can be summarised as follows:

a) Contractors can only request or compel the Employer to set aside the retention sum during the currency of the Contract;



- b) After the Contract is terminated and monies due from the Contractor is greater than the retention sum amount, the courts will not compel the Employer to do so, notwithstanding the amount deducted is in dispute;
 - c) Employer has the right to set-off against the retention sum any monies due from the Contractor to the Employer, provided the Employer has informed the Contractor in writing;
 - d) The only recourse for the Contractor is by claiming damages under the Contracts Act 1950.
- From the above stated position, Contractors is highly recommended to write to the Employer to request him to set up a trust fund and better still have a separate bank account to hold the retention sum from the very onset of the Contract coming into force. 

In the next issue of the MBAM journal the article will answer the question on "Is Contractor obliged to apply for Extension of Time ?"



The **Entrust Group** includes Entrust Consultancy Sdn Bhd (formerly known as J.D. Kingsfield (M) Sdn Bhd), BK Burns & Ong Sdn Bhd (a member of the Asia wide group BK Asia Pacific), Pro-Value Management, Proforce Management Services Sdn Bhd/Agensi Pekerjaan Proforce Sdn Bhd and International Master Trainers Sdn Bhd. Apart from project, commercial and contractual management services, the group also provides risk, resources, quality and value management, recruitment consultancy services and corporate training programmes to various industries, particularly in construction and petrochemical, both locally and internationally.

Entrust Group will provide 30 minutes of free consultancy with prior appointment to MBAM members on their contractual questions. The Group also provides both in-house and public seminars/workshops in its various areas of expertise. For further details, please visit website: www.entrust.com. or contact HT Ong or Wing Ho at 22-1& 2 Jalan 2/109E, Desa Business Park, Taman Desa, 58100 Kuala Lumpur, Malaysia. Tel: 6(03)-7982 2123 Fax: 6(03)-7982 3122 Email: enquiry@entrust.com.my.