CONSTRUCTION CONTRACT & MANAGEMENT ISSUES

In this second quarter issue of Master Builders Journal for 2010, BK Burns & Ong S/B, a subsidiary of BK Asia Pacific, a regional group providing project, commercial and contractual management services joins with Entrusty Group, a multi-disciplinary group, collectively named as BK Entrusty, presents a new series of contract and management articles in construction related areas of project, commercial, contracts, risks, quality and value, on “What is Fit for Purpose and its implications?”

INTRODUCTION

In the construction industry recently, the issues of “fit for purpose” and “suitability” have become increasingly controversial and are subjects of dispute between the contracting parties. Unfortunately, many contractors and sub-contractors have either misunderstood or did not appreciate the contractual and/or legal implications of such undertaking and liability when they enter into a contract with such term/s, either expressly stated or implied into the contract when they choose to propose alternative design under traditional/conventional contracting method or system.

In common law, there is an implied warranty that the goods shall be fit for such purpose for which they are required and that the buyer had relied on the seller's representation of the goods suitability, unless expressly disclaimed, excluded or modified.

Such warranty of fitness for purpose, whether implied or expressly stated, can be found in some construction contracts that require the Contractor to undertake some form of design liability such as in Design and Build contracts and those contracts with optional or alternative design provision.

In this article, BK Entrusty aims to provide readers with a better understanding of the terms Fitness for Purpose and Suitability, by answering the following:-

- Is the Contractor responsible to ensure that the nominated sub-contract works are fit for its purpose?

WHAT IS FIT FOR PURPOSE

There is an implied warranty on the party who furnishes the design to ensure adequacy and accuracy of its design. Therefore, in a Design and Build ("D&B") contract, the Contractor has a single point responsibility for both the design and construction of the project concern. Whether the design works are undertaken by the D&B Contractor's in-house design team or outsourced to others, he is still liable for the design and responsible to ensure that his works are fit for the intended purpose. In other words, for most D&B contracts, the Contractor is usually subjected to the liability of fit for purpose and/or suitability as he will be the one who not only design but build it, as well. Consequently, unless there is an express term which overrides this implied term, the Contractor is bound to deliver an end product which is fit for purpose, since the Contractor is responsible for both design and construction.

The duty of fitness for purpose of the design is a greater duty than the normal duty of "reasonable skill and care" placed on the Contractor. To prove liability of fit for purpose, the Employer merely needs to demonstrate that the works are not fit for its intended purpose. In the case of "reasonable skill and care", which is the lesser standard, the Employer would need to prove the following:

- that the works are defective and the defects arose due to the Contractor's defective design, materials and/or workmanship; and
• the design was carried out negligently or recklessly.

DIFFERENCE BETWEEN FIT FOR PURPOSE AND SUITABILITY FOR PURPOSE

According to Black Law Dictionary, fitness for a particular purpose is defined as "where the seller at the time of contracting his reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is, unless excluded or modified, an implied warranty that the goods shall fit for such purpose." ²

In essence, fit for purpose in design, whether express or implied, is where the designer warrants that the design will be functional.³ In most D&B contracts, this warranty is from the D&B Contractor.

Similarly, suitability is defined as fit and appropriate for the end product.⁴ Suitability for purpose in a design and build contract is usually implied, where the finished work will be reasonably suitable for the intended purpose, which the Contractor is aware of.⁵ In short, suitability for purpose concerns with whether the design, material and/or work process chosen by the Contractor is suitable for the purpose of the project.

RELATED PRINCIPLE

In Malaysia, the root of such implied term for Works to be fit for purpose stems from the Malaysian Act 382, Sale of Good Act 1957 ⁶, which states :-

"16. (1)

(a) Where the buyer, expressly or by implication makes known to the seller the particular purpose for which the goods are required, so as to show that the buyer relies on the seller's skill or judgment, and the goods are of a description which it is in the course of the seller's business to supply (whether he is the manufacturer or producer or not) there is an implied condition that the goods shall be reasonably fit for such purpose:"

In the case of Union Alloy (M) Sdn Bhd v Syarikat Pembenaan Yeoh Tong Lay Sdn Bhd, 1993 ⁷, it followed the four preconditions under Section 16(1)(a) of The Sales of Goods Act 1957 in determining the implied obligation and existence of fit for purpose, as follows:-

(a) the buyer must make known to the seller the particular purpose for which the goods are required;
(b) it must shown that there was reliance by the buyer on the seller's skill and judgment, and the buyer must in fact rely on the seller to supply suitable goods;
(c) the goods must be of a description which it is in the course of the seller's business to supply; and
(d) if the goods are specific, they must not be sold under their patent or trade name."

From the above principles, the design consultant/s of the D&B Contractor can be liable for their design to be fit for purpose.⁸ In the case of Greaves & Co (Contractor) Limited v Baynham Meikle & Partners (1975)⁹, it was held that fitness for purpose test may apply, depending on the facts of the case.

However, Greaves decision was rejected in the case of George Hawkins v. Chrysler (UK) Ltd. (1986)¹⁰, whereby it was held that, in a design and supply contract, there would be an implied term of design suitability, but in a contract for design service only, the professional designer would not normally warrant more than reasonable skill and care only.

FIT FOR PURPOSE

Under the traditional / conventional procurement method or system, the design of the project is usually developed by the Architect and/or Engineer engaged by the Employer and the Contractor is only obliged to construct it in accordance with the design requirements. However, in the case of design and build procurement, the Contractor is obliged not only for the construction but also the design, as well.

In most design and build contracts, the D&B Contractor assumes a higher level of design liability than a designer under traditional / conventional building or construction contracts. For example, under a traditional / conventional contract, in the absence of an express term, the designer will have an implied obligation to carry out his design with reasonable skill and care only. However, under D&B contract, in the absence of an express term, there is an absolute duty to produce a design which is reasonably fit for its purpose and he will be held responsible for failure in design, irrespective of whether the problem was caused by negligence or not.¹¹
Notwithstanding, there are cases where the D&B Contractor may construes that his liability for design should only be confined to one of due care or professional care and not of a higher duty of a professional designer. However, according to Hudson such arguments have often been rejected by the courts.

Further, in order to prove liability in fit for purpose, it would require not only the element of specific purpose, but also the Employer’s reliance on the Contractor’s skill and judgement. Without these two elements, the implied term of fit for purpose is not applicable. In the case of Viking Grain v White (1985), the judge held that, when these two elements are present, the Contractor will then be liable for fit for purpose.

SUITABILITY FOR PURPOSE

When a contract states the purpose of the project, and the Contractor undertakes the design, he is then responsible for the effectiveness of the design and suitability for its intended purpose. In other words, suitability for purpose not only concerns with the design obligation, but also whether the material and work process chosen by the Contractor are suitable and fit for the project purposes. In traditional / conventional procurement method or system, where the Contractor is supplied with the design, the Contractor is only obliged to construct in accordance with the design in a workmanlike manner using the specified components and/or materials. Even if he may be fully aware of the purpose of the project, he is only obliged to warn the Architect and Engineer of any design deficiencies or discrepancies which he is or should be aware of. On the other hand, if the Contractor provides the whole design or a part of it is left to his judgement and choice, it is implied that the work or materials will be suitable for the purpose of the project.

MALAYSIAN STANDARD FORMS OF CONTRACT

Generally, some contract terms are either not expressly written or are not required to be stated in the contract but nonetheless form part of the contract. Contractual terms which are written explicitly are called express term, whilst those not stated in the contract but yet binding on the Contractor are called implied terms. Implied terms may qualify as express terms but they certainly cannot override them, unless on the grounds of unfair and void terms.

Conversely express terms are terms written in the contract, which will override the implied terms. As such, in any contract where its express term appears to be inconsistent with the implied term, then the express term shall prevail.

It is common for contractors to overlook such implied terms or they are not aware of their obligations under such implied terms. One of the most common implied terms overlooked by contractors under Design and Build contracts is that they have to ensure that they are fit for purpose.

Fit for purpose and suitability for purpose warranties are express terms in many standard form of design and build contracts, including those in Malaysia. Such clauses can be found in the following standard forms of contract:

1. CIDB D1 Clause (a), (d) and D2 (a)(ii)
2. Standard Form of Design and Build Contract PWD Form DB (Rev. 2007) Clause 14.1 (a)
3. PWD Form 203A (10/87) Clause 22.1 (a) and (c)

The clause that contains express term of fit for purpose and suitability in the Standard Form of Design and Build Contract PWD Form DB (Rev. 2007) is Clause 14, as stated below:

14.0 DESIGN
14.1 Design
a. The Contractor shall be fully responsible for the design, execution and maintenance or the Works/ portion of the Works for which his design/alternative design have been accepted by the government. The Contractor further guarantees to the Government that the design, materials
and workmanship of the Works or portion of the Works complies with the Government’s Requirements as well as are suitable and fit for purpose and independent work.

SHOP OR PRODUCTION DRAWINGS BY CONTRACTORS AND DESIGN BY NOMINATED SUB-CONTRACTORS

As mentioned above, if the drawings and specifications produced by the Architect and/or Engineer engaged by the Employer are supplied to the Contractor for construction, as in contracts procured traditionally, the Contractor is only obliged to construct in accordance with the design requirements. However, under such contracts, it is very common for the Contractor or his domestic sub-contractors to produce shop or production drawings to amplify details not available from the design supplied or necessitated by the method of construction adopted. In doing so, the Contractor may have unwittingly, in the absence of an express term in the contract, undertaken the obligation of fit for purpose for the works which he has designed or developed by way of shop or production drawings.

Such drawings are usually forwarded to the Architect and/or Engineer for their checking and approval. The approval of such drawings by the Architect/Engineer will usually not absolve the Contractor from the liability of fit for purpose. On the other hand, if the terms of appointment with the Employer do not permit the use of the Contractor or others to undertake the design works (in whole or in part/s), the Architect/Engineer is then responsible for its design work, without powers to delegate its duty to others.

Consequently, should the Employer suffers a loss as a result of the failure in the Contractor’s design, the Employer can bring an action against the Architect/Engineer and/or Contractor, either individually or jointly.

In the case of nominated sub-contracting, the nominated sub-contractors, who are appointed by the Architect/Engineer to carry out specialist works, which usually encompasses design, will invariably be obligated for fit for purpose. In the construction industry, it is common for these sub-contractors to be in direct liaison with the Architect/Engineer for its specialist design, without the Contractor’s involvement and knowledge.

In the absence of any express term to exclude design liability, the Contractor is usually obliged for fit for purpose to the design by the aforesaid sub-contractors. This is by virtue of Clause 27.7 of PAM 1998, which states that the Contractor shall be fully responsible for any default or breach of contract by the NSC, the Contractor will be liable for any design faults of the NSC.

However, in the later form, under Clause 27.1 of PAM 2006, it provides that if there is an element of design by the NSC or if judgement of the NSC is required, then it is the responsibility of the NSC and not the Contractor to ensure that the sub-contract works are fit for its purpose.

Therefore, in the absence of an express term to exclude liability, or the existence of an express term that include liability, such as Clause 27.7 of PAM 1998, it would be prudent for the Contractor to insist on a design warranty directly between the Employer and the NSC. Such practice is common in the UK, whereby a collateral warranty is often required by Employer.

LOCAL CASE LAWS

The following are legal cases on matters relating to fit for purpose and suitability in Malaysia.

**Teh Khem On & Anor v Yeoh & Wu Development Sdn Bhd & Ors [1995] 2 AMR 1558**

In this case, the plaintiffs, who were the purchasers, had entered into a sale and purchase agreement with the 1st defendant, the builder, to purchase a house which was subsequently found to be defective. The builder admitted his liability and carried out repairs to remedy the problems, but was found to be ineffective.

The purchasers then brought an action against the builder for, inter alia, rescission of the agreement, refund of the purchase price and claim for damages.

It was held that the builder was in breach of an express condition in the agreement which provided that the house must be constructed in a good and workmanlike manner. The builder was also in breach of the three implied conditions of the agreement, i.e. that it would do his work in a good and workmanlike manner, it would supply good and proper materials, and the house was reasonably fit for human habitation.

**Dr Abdul Hamid Abdul Rashid & Anor v Jurusan Malaysia Consultants & Ors [1999] 8 CLJ 131**

The owner depended on the defendant’s designer (fourth defendant) to design his house in Lot 3007. The defendant was to be advised by the designer that the designed house was to comply with the Government’s Requirements and be suitable and fit for purpose and independent work.
structures were adequate and safe for its intended purpose. The house was completed on April 1985, however no certificate of fitness was issued although there was an inspection by the relevant authority. On the 18 September 1988, half the house collapsed due slope failure caused by lateral movement of the earth supporting the house foundation. It was held that the defendant’s designer had failed to design for habitation that was fit for purpose. As a result of the house collapse, the defendant was liable for the breach of contract.

Sunrise Bhd & Anor v L & M Agencies Sdn Bhd [1999] 7 CLJ 340

The 2nd plaintiff, who was the Main Contractor of 1st plaintiff had entered into an equipment sales agreement, which included a maintenance service agreement with the defendant to acquire two new tower cranes to facilitate the construction of two condominium blocks. However, the cranes frequently broke down and were inoperative for a long period of time. The 2nd plaintiff claimed that the acquired cranes were not fit for purpose and relied on S.16(1)(a) of the Sales of Good Act 1957 ('the Act') to claim for loss and damage caused by the said cranes.

The court held that in order for S.16(1)(a) of the Act to be applicable, there were four pre-conditions that must be satisfied, which was in line with the earlier decided case of Union Alloy (M) Sdn Bhd v Syarikat Pembenaan Yeah Tiong Lay Sdn Bhd, 1993.

SUMMARY/CONCLUSION

There is an implied warranty on the party who furnishes the design to ensure adequacy and accuracy of the design. Therefore, in D&B contracts, a Contractor who is responsible for the design and the construction works must ensure that works done are not fit for purpose and relied on S.16(1)(a) of the Sales of Good Act 1957 ('the Act') to claim for loss and damage caused by the said cranes.

Fit for purpose and suitability for purpose warranties are express terms in most Malaysian standard form of design and build contracts. In traditional procurement method/system, where the Contractor is supplied with the design, the Contractor is only obliged to construct in accordance with the design in a workmanlike manner even if he may be fully aware of the purpose of the works, subject to the duty to warn the Architect and Engineer of any design deficiencies or discrepancies which he is or should be aware of.

However, under such contracts, it is very common for the Contractor or his domestic sub-contractors to produce shop or production drawings, in doing so, and in the absence of an express term in the contract, the Contractor has unknowingly undertaken the obligation of fit for purpose for the works designed. Even approval of the drawings by the Architect/Engineer for construction will not absolve the Contractor from the liability of fit for purpose. In short, the Contractor can be liable for the Employer’s losses in the event of failure in the Contractor’s design.

In the absence of an express term to exclude liability, the Contractor has also undertaken the obligation of fit for purpose for any design undertaken by its sub-contractors, domestic and/or nominated. Therefore, it would be prudent for the Contractor to insist on a collateral design warranty directly between the Employer and the NSC concern.

In conclusion, contractors should appreciate and understand the terms of fit for purpose and suitability as they may be liable for the design of their sub-contractors, which they undertook to carry out for the project. Consequently, it will be prudent for contractors and sub-contractors to be cautious, before committing to any design option or alternative, beyond the contract requirements, unless the contract itself is of design and build in nature.

In the next issue of the MBAM journal the article will answer the question on “Can the Contractor be terminated after substantial completion of its Works?”

REFERENCES:


Entrusty Group is a multidisciplinary group of companies which comprises Entrusty Consultancy Sdn Bhd (formerly known as J.D. Kingsfield (M) Sdn Bhd), BK Burns & Ong Sdn Bhd (a member of BK Asia Pacific Ltd, Hong Kong), Pro-Value Management Sdn Bhd (in association with Applied Facilitation & Training, Australia), International Master Trainers Sdn Bhd (in association with Master Trainer of New York), Agensi Pekerjaan Proforce Sdn Bhd, Alpha-Omega Matrix and Entrusty International Pte Ltd. The Group provides comprehensive consultancy, advisory and management services in project, commercial, contracts, construction, facilities, risks, quality and value management, cost management, executive search/personnel recruitment and corporate training/seminars/workshops to various industries particularly in construction, petrochemical, manufacturing and IT, both locally and internationally. For further details, visit www.entrusty.com.

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