Construction Contract & Management Issues

In this first quarter issue of Master Builders Journal for 2014, BK Burns & Ong Sdn Bhd, a subsidiary of **BK Asia Pacific**, an international construction consultancy group providing project, commercial and contractual management services joins with **Entrusty Group**, a multi-disciplinary group, collectively named **BK Entrusty**, to present a **new series of construction contract and management articles** in areas related to project, commercial, contracts, risks, quality, value and the like. This article on ***"The Impending Demise of Conditional Payment Clauses in the Malaysian Construction Industry"*** will be in three parts. Part Two is published in this quarter and Parts Two and Three in the following quarters.

INTRODUCTION

In the Malaysian construction industry it is a common practice that many contractors sub-let their works to subcontractors on 'pay-when-paid' or 'pay-if-paid' basis. This means that unless the Contractor receives payment from the Employer, the Sub-Contractor will not receive its corresponding payment. Unfortunately, sub-contractors are often burdened and suffer financially as a consequence of such practice, particularly when non-payment by the Employer to the Contractor bears no relation to the Sub-Contractor's payment entitlement for its sub-contract works.

In many cases, when the Contractor is related to the Employer directly or indirectly, such payment provision is often introduced into the Sub-contracts, with ulterior motive and/or ill-intent of delaying or simply not paying the subcontractors. Unfortunately, the courts which have been deciding on such payment provisions on payment disputes by the contracting parties have so far ruled and decided in favour and have enforced them, accordingly.

With the advent of Construction Industry Payment and Adjudication Act ("CIPAA") 2012 which was gazetted on 22nd June 2012 coming into force soon, such bad practices in Malaysia will soon be purged. The primary objective of CIPAA is to address cash flow problems in the construction industry by *"removing the pervasive and prevalent practice of conditional payment ('pay when paid', 'pay if paid' and 'back to back') and reduces payment default by establishing a cheaper and speedier system of dispute resolution in the form of adjudication"* (KLRCA , 2012).

In this three part Article, BK Entrusty aims to provide readers with an appreciation of the past and present payment practices and provisions of conditional payment in Malaysia in the First Part, review the payment provisions and their implementation and practices in countries like United Kingdom, Australia and Singapore, which have statutory Adjudication Act in the Second Part and introduce CIPAA on its pertinent features and provisions, including the issues, challenges and implications in the Third and Final Part.

The following are the main sub-headings of this three part Article:

Part One

- Introduction
- Past and present construction payment provisions and practices in Malaysia
- Payment provisions in United Kingdom, Australia and Singapore

Part Two

- Introduction
- Post Adjudication scenarios in United Kingdom, Australia and Singapore.

Part Three

- Introduction
- Pertinent features and provisions of CIPAA
- Issues, challenges and implications
- Summary/Conclusion
- References/Bibliography

Part Two of this three part Article, is presented below.

POST ADJUDICATION SCENARIO IN UNITED KINGDOM, AUSTRALIA AND SINGAPORE.

Statutory and mandatory adjudication has been practiced almost two decades already in UK and about one decade in Australia and Singapore. Throughout this duration, the payment legislations have shown a significant progress and positive impact on the construction economy and cash flows in these countries, as follows;

United Kingdom

According to Adjudication Reporting Centre of Glasgow Caledonian University, UK (2010), the average number of adjudication cases conducted yearly was between 1000 to

2000 cases per year. It is also recorded that Claimant, had been the most successful party, with success rate of 60% to 74% of the cases yearly. However the recorded complaints against Adjudicator were only between 0.45 to 1.19 % per year.

The following is a tabulated finding of the subject areas of disputes in adjudication:

Subject	2004	2005	2007	2008
Valuation of Final Account	12%	14%	22%	22%
Failure to comply with Payment Provisions	19%	8%	14%	19%
Valuation of interim payments	15%	13%	15%	16%
Withholding monies	10%	11%	10%	10%
Extension of Time	8%	8%	8%	9%
Loss and Expense	9%	10%	2%	7%
Valuation of Variations	15%	17%	11%	5%
Defective Work	4%	5%	7%	4%
Determination	2%	3%	4%	4%
Non-payment of fees	2%	1%	7%	2%

Table 1: Primary subjects of the disputes (Glasgow Caledonian University, 2010)

Australia (New South Wales)

According Adjudicate Today (2012) which is one of Australia Authorised Nominating Authority, the number of adjudication applications are, as follow:

Year	Adjudication Applications	Amount Claimed	Adjudication Determinations	Adjudicated Amounts
2003	482	$178,238,581	341	$38,521,279
2004	786	$279,244,827	625	$155,941,470
2005	917	$867,026,763	713	$212,747,199
2006	919	$539,447,779	695	$94,137,842
2007	894	$263,230,279	670	$79,470,211
2008	960	$198,388,906	660	$67,467,520
2009	939	$223,008,213	625	$80,906,018
Total	**5897**	**$2,548,585,351**	**4329**	**$729,191,542**

Table 2: Adjudication activities in New South Wales since March 2003 (Department of Services Technology and Administration).

It was recorded that the most frequent party to a payment claim dispute is the Subcontractor (as a Claimant) and the Contractor (as the Respondent).

As reported by Coggins, Elliot and Bell (2010), there have been at least 210 New South Wales Supreme Court judgments and 41 New South Wales Court of Appeal judgments recorded since 2001 concerning the BCSIP Act. Majority of the cases was on setting aside of adjudicator's determination.

Singapore

According to Singapore Building and Construction Authority (BCA, 2012), the adjudication cases reported from 2005 until 2012 amounted to 704 cases. From these cases, about 54% of the cases were succeeded by claimants and 11% succeeded by respondents. The rest of the cases are either invalid adjudication applications or withdrawn applications. The largest number of parties to adjudication is similar with UK and Australia, which are Sub-Contractor as the Claimant and Contractor as the Respondent.

BCA (2012) further reported that there are 18 adjudication review applications in which 12 of them were valid applications. This statistic proved that only a small portion of adjudication cases applied to be reviewed in Singapore.

Challenges to the Adjudication

As reviewed above, it can be concluded that only a small portion of the adjudication cases or applications in UK, Australia and Singapore were reviewed or challenged by the parties to the adjudication. Nevertheless, it is prudent to discuss what are the challenges raised in adjudication and the attempts of the disputing parties to avoid being involved in adjudication itself.

In UK, an attempt to evade the adjudication provisions in HGCR Act was recorded in the case of ***Bridgeway Construction Ltd v Tolent Contruction Ltd [2000] CILL 1662.*** A clause in the agreement required the party who referred the dispute to adjudication to bear all the cost of the adjudication which the clause was later called "Tolent clause". The Adjudicator awarded sum of money to the Claimant but rejected Claimant's request for the cost due to the above provision. The Claimant brought the issue of the adjudication cost to the High Court and argued that the clause was void because its intention was to deter reference to adjudication. The Judge rejected the Claimant's argument and held that the provision was not void.

However, the Tolent clause was rejected in ***Yuanda (UK) Co Limited v WW Gear Construction Limited [2010] EWHC 720 (TCC).*** HH Mr Justice Edwards-Stuart said at paragraphs 49, 51 and 54 that:

"49… If the effect of the contract drafting is to "clearly discourage a party from exercising its right to refer disputes to adjudication", then it must be for consideration whether a provision so drafted is contrary to the requirements of HGCRA."

51. For these reasons, I consider that clause 9A would in practice limit Yuanda's freedom to refer a dispute to adjudication at any time and, in some circumstances – such as in a dispute involving a relatively small amount of money – to deprive it of a remedy altogether. I must therefore respectfully disagree with the conclusion reached by HH Judge Mackay in the Tolent case, at least on the basis of the wording of clause 9A in this particular contract."54. For the reasons set out in this section of the judgment, I consider that clause 9A is in conflict with the requirements of section 108 of HGCRA and the Scheme."

HH Mr Justice Edwards-Stuart concludes at paragraph 65 that:

"For the reasons that I have given, therefore, clause 9A must go in its entirety and be replaced by the provisions of Part I of the Scheme."

Further to overcome the Tolent clause, UK has implemented Local Democracy, Economic Development and Construction (LDEDC) Act 2009 in 2011 which prohibited any contractual provision made between the parties to a construction contract which concerned the allocation as between those parties of costs relating to the adjudication (Section 141).

Another development in adjudication introduced by LDEDC Act was adjudication was no longer applicable only to the written contract. This is to say that contracts wholly in writing, partly in writing and partly oral and wholly oral will all equally be subject to the legislation. Nevertheless, the adjudication provision for any construction contract has to be in writing or else the Scheme for Construction Contracts will apply. Australia already adopted this rule in its BCISP Act.

LDEDC Act further introduced a "slip rule" under Section 140, which allowed for the adjudicator to correct a typographical or clerical error arising by accident or error in his or her decision.

As mentioned earlier, in New South Wales, Australia, there have been at least 210 New South Wales Supreme Court judgments and 41 New South Wales Court of Appeal judgments were recorded since 2001 concerning the BCSIP Act. Majority of the cases were on setting aside of adjudicator's determination. In 2009 alone, there were at least 21 judgments held by New South Wales Supreme Court for one reason or another, sought to challenge the payment of an amount determined in adjudication (Coggins, Elliot & Bell (2010)).

Principal Issue before the Court	No. of Cases
Whether payment claim (in full or in part) is valid	5
Whether a construction contract or arrangement within scope of Act exists	5
Whether plaintiff was denied natural justice and/or adjudicator failed to make a bona fide attempt to exercise his/her task under the Act	2
Whether under the Corporations Act a genuine dispute exists for an off-setting claim against the adjudicated amount which the claimant is trying to enforce by statutory demand	2
Whether there has been an abuse of the processes under the Act	1
Whether adjudicator correctly applied s 34 of the Act to include sums in the adjudicated amount over and beyond an agreed sum in the contract	1
Whether adjudicated amount should be corrected	1
Whether adjudicator was validly appointed	1
Whether damages claimed in adjudication application outside of scope of payment claim	1
Whether reasons for withholding payment can be incorporated by reference into the payment schedule	1
Whether payment schedule can be provided by an agent of the respondent	1
Total	**21**

Table 3: Judgments of the New South Wales Supreme Court in 2009 with respect to applications challenging payment of adjudicated amount (Coggins, Elliot & Bell (2010)).

Coggins, Elliot & Bell (2010) commented this scenario as *"may be reflective of a lack of clarity with respect to the legislative drafting leaving many issues to be interpreted and given certainty by the judiciary. Hence, there has been, and still appears to be, the potential for respondents to argue that an adjudicator's determination should be set aside on the basis of several issues. These include issues relating to delay damages, grounds for reviewability of an adjudicator's determination, payment claim reagitation or issue estoppel, information to be included on a duly submitted payment claim (Protectavale Pty Ltd v K2K Pty Ltd [2008] FCA 1248), the scope of section 34 of the Act with respect to voiding contractual provisions which restrict the operation of the Act, and conflict between the Act and Federal corporations and trade practices law."*

Nevertheless, there are number of Australian cases that we can refer to when it comes to the adjudication. Recent case on ***Chase Oyster Bar v Hamo Industries [2010] NSWCA 190*** has set a new milestone in setting aside an adjudication determination due to jurisdiction error.

Spigelman CJ at 1; Basten JA at 62; McDougall J at 110 held that

"The Supreme Court, in exercise of its supervisory jurisdiction:

a) has power to determine that –

i. *an adjudication application has not been made in compliance with s 17(2)(a) of the Building and Construction Industry Security of Payment Act 1999;*

ii. *the determination of the adjudicator, made in the absence of a valid adjudication application, was invalid, and*

iii. *there was non-compliance in the present case;*

b) has power to grant relief in the nature of certiorari and set the determination aside."

In addition the Court overturned the decision made by *New South Wales Court of Appeal in Brodyn Pty Ltd v Davenport (2004) NSWCA 394* as follows;

"Question 2:

Whether in light of the decision of the High Court Kirk v Industrial Relations Commission [2010] HCA 1 the decision in Brodyn Pty Ltd v Davenport (2004) 61 NSWLR 421 should not be followed or was incorrectly decided so far as it held that:

a) the Supreme Court of New South Wales was not required to consider and determine the existence of jurisdictional error by an adjudicator in reaching a determination under the Act;

b) an order in the nature of certiorari was not available to quash or set aside a decision of an adjudicator under the Act;

c) the Act expressly or impliedly limited the Supreme Court of New South Wales' power to consider and quash a determination for jurisdictional error by an adjudicator in reaching a determination under the Act.

Answer:

To the extent that Brodyn Pty Ltd v Davenport held, in relation to an adjudication application which was not in compliance with s 17(2)(a) of the Act, the matters set out in the question at a, b and c, it was in error."

Another interesting adjudication development aroused out of the Singapore High Court in the case of ***Sungdo Engineering & Construction (S) Pte Ltd V Italcor Pte Ltd [2010] SGHC 105*** ("Sungdo"). One of the main issues was, "when a payment claim not a payment claim". In this case, the Defendant served the Plaintiff a letter setting out the Defendant's claim with supporting documents (referred to in the decision as the "2008 Letter").

The Court ruled that the 2008 Letter did not constitute a valid Payment Claim under the Act although the 2008 Letter contained the information prescribed in the SOP Act and Regulations. The reason being is stated by the Court, as follows;

a) ***"The defendant did not communicate its intention to the plaintiff that it was a payment claim under the Act.***

b) *The plaintiff did not treat it as a Payment Claim.*

c) *Event prior to the service of the 2008 Letter suggested that this was not a Payment Claim.*

d) *The contents of the covering letter did not suggest it was Payment Claim.*

e) *Public policy."*

The Court held that in order for a payment claim to be a valid payment claim, it should be intended to be a claim under the SOP Act and such intention must be communicated whether in written or orally to the Respondent.

In recent cases, the "validity" of progress payment especially under adjudication case, was further developed. In case of ***Lee Wee Lick Terence (alias Li Weili Terence) v Chua Say Eng (formerly trading as Weng Fatt Construction Engineering) and another appeal*** **[2013] 1 SLR 401** which later referred to as *"Chua Say Eng"* case. The Judge agreed with the method adopted in the above *Sungdo Case* and stated:

"we are of the view that the decision in Sungdo *is applicable to its own peculiar facts, and the correct test for determining the validity of a payment claim is whether a purported payment claim satisfies all the formal requirements in s 10(3)(*a*) of the Act and reg 5(2) of the SOPR. If it does, it is a valid payment claim"*

Furthermore, the court rejected the argument of SOP provisions 10(2) and 5(1) were setting a limitation period for the service of payment claim. For ease of reference the said provisions are cited below:

Section 10(2) of the SOP Act

10. (2) A payment claim shall be served —

(a) at such time as specified in or determined in accordance with the terms of the contract; or

(b) where the contract does not contain such provision, at such time as may be prescribed."

Regulation 5(1) of the SOP Regulations

5. (1) Where a contract does not contain any provision specifying the time at which a payment claim shall be served or by which such time may be determined, then a payment claim made under the contract shall be served by the last day of each month following the month in which the contract is made."

The Court rejected such argument and stated that "*In the context of s 10(1) of the Act, or in its own context, reg 5(1) of the SOPR should not be interpreted so narrowly as to unduly restrict the rights of claimants under the Act. Regulation 5(1) does not say that a claimant must make a payment claim on a monthly basis for work done up to or in the previous month."* The Court further opined that the aforesaid provisions served to impose a maximum frequency of one payment claim per month, which it felt was fair and reasonable to parties.

The Court concluded that the SOP Act was intended to facilitate the payment of progress payments at monthly intervals for the benefit of claimants which mainly contractor. If the contractors choose not to adopt this benefit, there is no reason to compel them to do so. This would also benefit respondents (mainly the paymaster) who need not to pay monthly claims.

In addition, the Court also ruled that the final payment was a part of progress payment via its statement:

"Even though no argument has been made to us on whether a final payment is a progress payment as defined, it seems to us that the definition is wide enough to include a final payment as it is a payment, albeit final, to which a person is entitled for the carrying out of construction works"

Note : References/ Bibliography to this article will be included in Part Three.

Part Three of this Article will be published in the subsequent quarter of the MBAM Journal.
