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The Adequacy of Malaysian Security of Payment Legislation for Sub-contractors in Construction Industry

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Abstract

In Malaysia, the particularly small sized subcontractors are definitely benefited from payment provisions in the proposed *Construction Industry Payment and Adjudication Act* (CIPA Act). However, they need to enhance their knowledge of the so-called the 'Security of Payment' Regime to benefits from the Act. Due to this, this on-going research attempts to introduce payment framework to the sub-contractors, in giving the knowledge, to claim for payment. This paper, though, is to disclose the finding of the level of knowledge that the sub-contractors have to the proposed Act, by preliminary analyzing the quantitative questionnaire survey. It was found that the adequacy of security of payment framework to the particularly small sized sub-contractors needs to be produced, and the analysis on effectiveness of the various avenues incorporated in the construction contract or statutes in the other developed countries as well as the proposed Act needs to be done. However, as long as the regime remains in proposal, the sub-contractors have to bear with the current structure of payment mechanisms in the standard forms of contract, which are payment upon certification, direct payment from the employer, and contingent or conditional payment.

Keywords

legal readiness, Malaysia, sub-contractors, security of payment, construction industry.

1. Introduction

In any country's progress development, an essential function is acted by the construction industry which is both growth-initiating and growth-dependent (Abdullah, 2004). Buildings and infrastructure works is established by the industry which give to the large economic increase required for social economic development. Disposal incomes which generate extra construction activities will be further guided to a raise by the achievement of economic development (Sin, 2006).

In usual engineering and construction contracts in relation to the contract entered into by the parties, it is the contractor's consideration to deliver the works, e.g. construction, installation, material supply, etc. This represents his piece of the bargain or the promise made. In reciprocation, the employer should maintain his essential consideration or part of the his bargain by furnishing the which is in the most cases in the shape of money (Singh, 2006).

Payment has been believed to be the life-blood of the construction industry. However, payment default particularly delayed and non-payment, is known by the industry to stay as a main problem (Ameer-Ali, 2006). May & Siddiqi (2006) states that well-timed run of money is required for the achievement of a construction project, commencing the owner in the direction of the contractor downwards to the subcontractors, sub-subcontractors, suppliers, and vendors. However, they further added that in the

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subcontract, contractors frequently try to transfer the risk of the owner's non-payment to subcontractors. This is done by including contingent payment provisions, for instance pay-when-paid or pay-if-paid clauses.

2. Payment for Sub-contractor

There has been no widely local study, in the Malaysian environment, on security of payment regime. Instead, the study undertaken is on the likely introduction of a Malaysian Construction Industry Payment and Adjudication Act (Ameer-Ali, 2006) and attention to the Malaysian Government on the choices for its requirements (Constable, 2006). This study in the perspective of the Malaysian construction industry, given the lack of study relating to this matter, has the prospective to offer a realistic understanding and better theoretical of the probable usefulness of the security of payment regime (Che-Munaaim, 2009).

2.1 Principle Methods of Paying Sub-contractor

There are three principle methods of paying the subcontractor in consideration for the work executed: 'payment upon certification', 'direct payment', and 'contingent payment'. Even though the main contractor disbursing the required payment to the sub-contractor in the first and third methods, the second method is only an employer and sub-contractor deal. As much as the payment of the amount due is concerned, the main contractor being a sheer concerned third party or 'bystander' in the second method (Singh, 2006).

2.1.1 Payment upon certification

Under this payment regime, the receiving of the interim payment certificate by the main contractor is the conditions precedent for the sub-contractor's right to payment, as well as the after that lapse of the distinct 'window-period' for payment. The main contractor not having received from the employer the supposed amount or his honouring period to repay the sub-contractor is longer than the grace period being specified to him is irrelevant. The clock starts ticking against him once he receives the pertinent certificate, in view to his obligation to pay (Singh, 2006).

2.1.2 Direct payment from the employer

Under this payment regime, payments are paid straight to the sub-contractor concerned by the employer, even though the payments payable to the sub-contractor are incorporated in the Interim and/or Final Certificates to the main contractor. This is due to the fact that such payments are unpaid, as in the conventional way, through the main contractor. However, the main contractor is disbursed only the pertinent profit and attendance for the supposed sub-contractor (Singh, 2006).

2.1.3 Contingent payment or conditional payment

'Contingent payment' is a third ordinary method available for paying sub-contractors, which encompasses a numeral of labels such as 'pay if paid' clauses, 'pay when paid' clauses, and 'back-to-back' clauses" (Singh, 2006). May & Siddiqi (2006) state that the risk may not be efficiently transferred by a generally drafted contingent-payment terms to the degree projected by the contractor. Most courts differ very much on their keenness to put into effect contingent payment provisions, and such enforcement depends on the exact phrasing of the clause.

However, the construction afforded to the understood type of contingent payment clauses under dissimilar jurisdictions does not demonstrate some uniformity. Furthermore, the instant the circumstances is so gloomy that no common main beliefs can be distilled. In sight of the present vague point of the whole understanding procedure, it is maybe helpful to glance at the related case law and/or authoritative pronouncements to shed some illumination on this subject and give several direction to practitioners" (Singh, 2006).

2.2 Avenues to Improve Payment Problems

In the construction industry, there are a variety of avenues that are offered to improve the payment problem. A few of these options have been included in the construction contract or statutes in the other developed countries. The most excellent solutions should be opted and implemented which best suits and serves the Malaysian construction industry (Sin, 2006). In summary, these avenues include:

2.2.1 Suspension of work or going slow

Clause 30.7 of the Agreement and Conditions of PAM Contract 2006 (With Quantities) and Clause 42.10 of the CIDB Standard Form of Contract for Building Works 2000 Edition provide for suspension of work. In general, there are no right for suspension of work in common law (Ameer-Ali, 2006) for non-payment. In the *Kah Seng Construction Sdn Bhd v Selsin Development Sdn Bhd* [1997] 1 CLJ Supp 448 case (as cited in Fong, 2005), Low Hop Bing J succinctly held: *“In my judgment, it is trite law that a contractor can only terminate his contract with his employer (at common law, as opposed to the exercise of an express termination clause) if he shows, inter alia, a repudiatory breach by the employer has evinced an absolute refusal not to perform his side of contract. There is no intermediate right in a building contract to suspend works. By suspending works without valid legal cause, the plaintiff has in fact repudiated its contractual obligations.”*

2.2.2 Eradication of “pay when paid”

The standard forms of construction contract do not provide for such a remedy other than the CIDB Standard Form of Contract for Building Works 2000 Edition under Option Module C Clause C3.(c). If the sub contract is subjected to a “pay when paid” form, the correct of suspension is ineffective. Except of the contractor has absconded with money paid by the employer, this is somewhat ordinary (Fong, 2005).

2.2.3 Adjudication

Adjudication is provided in the Agreement and Conditions of PAM Contract 2006 (With Quantities) under Clause 34.0. Following that a judgment is obtained, in the United Kingdom, the adjudication procedure does not create the claimant a secured creditor. Summary judgment must be applied to the court by the successful claimant and after that, the decision in the common ways must be performed (Fong, 2005).

2.2.4 Liens

No construction contract elsewhere provide clause on lien, but the United States of America and Canada addressed it by way of mechanic lien statutes that is absent in Malaysia. “Any try to give security for payment to a contractor, subcontractor or supplier through a lien (Fong, 2005) or charging order method may not be in the most excellent public importance and by numerous of the parties – mainly the purchasers” (Ameer-Ali, 2006).

2.2.5 Trust

The trust concept is not alien in Malaysia in respect of retention of monies. It is provided in Clause 30(6)(a) of the Agreement and Conditions of PAM Contract 2006 (With Quantities) and Clause 42.3(c)(i) of the CIDB Standard Form of Contract for Building Works 2000 Edition. Nevertheless, the trust is a conditional one. It permits allowable deductions to be set off by the contractor or the employer (Fong, 2005).

2.2.6 Payment bonds

Clause 42.1(e) of the CIDB Standard Form of Contract for Building Works 2000 Edition provide for payment bond. Supardi, Adnan, & Yaakob (2009) further stated that to be an undisputed meaning of the words in the performance bond, as in payment bonds, the performance bond itself should be either purely conditional or purely unconditional 'on-demand' bond. The best examples for this are in the cases of *Esso*

Petroleum Malaysia Inc v Kago Petroleum Sdn Bhd [1995] 1 MLJ 149 and *IE Contractors Ltd v Lloyd's bank plc and Rafidain Bank* [1990] 2 Lloyd's Rep 296.

2.2.7 Direct payment from principal

Direct Payment is provided in the P.W.D. Form 203A (Rev. 2007) Standard Form of Contract to be Used Where Bills of Quantities Form Part of the Contract under Clause 60.1.

2.2.8 Contractor's project account

The prospect of creating a 'contractor's project account' have been 'creative' suggestions by REHDA. However, this has so far to be explored in detail (Ameer-Ali, 2006).

2.3 Sub-contractor's Readiness

Uher & Brand (2008) concludes in their study that the force of the Act has been an optimistic one from subcontractors' viewpoint. Subcontractors, mainly those making lesser payment claims, have been extremely winning at adjudication under the Act,. Nevertheless, subcontractors usually have been revealed to have a little level of understanding and operational knowledge of the adjudication procedure. In order to improve the knowledge of the Act, extra attempt to develop their awareness of the benefits of the Act is essential amongst mainly small sized subcontractors.

3. Aims of the Research

As in Supardi, Adnan & Mohammad (2010), the aim for the on-going research is to introduce balance frameworks (i.e. neither the main contractor nor the sub-contractor is at loss) on ways for the sub-contractor manages to claim the necessary payment and for the main contractor able to make the prompt payment. In order to meet the aim, therefore, the objectives of this research are:

- To identify the current legal aspect of payment provisions in the standard forms of contract as well as in the domestic sub-contract, especially on Contingent Payment.
- To explore the real problems and legal issues disputed by the sub-contractor and the main contractor relating to payment by analyzing judgment made in law cases.
- To determine the level of knowledge that the sub-contractors have to the proposed *Construction Industry Payment and Adjudication Act* (CIPA Act).
- To investigate the various avenues available for the main contractor and the sub-contractor, those have been incorporated in the construction contract or statutes in the other developed countries, which improve the payment problem, with the Malaysian construction contract and legal issues as well as the proposed *Construction Industry Payment and Adjudication Act* (CIPA Act) that has yet to be introduced in the industry.

Supardi, Adnan & Mohammad (2010) further conclude the first objectives that in the standard forms of construction contracts, currently, the payment structure to the sub-contractors are divided into three: payment upon certification, direct payment from the employer, and contingent payment or conditional payment. As long as the Malaysian 'Security of Payment' Regime remains in proposal, the sub-contractors have to bear with the current structure of payment mechanisms.

Then for the second objectives, Supardi, Adnan & Mohammad (2011) find that the analysis of law cases set up the issues and judgment on related matters on payment mechanism to sub-contract works. The issues are listed as follows:

- a) Agreement on the terms of payment
- b) Counter claim
- c) Delay

- d) Direct payment
- e) Final payment and certification
- f) Injunction
- g) Insolvency or winding up
- h) 'Pay-when-paid' clause
- i) Performance bond
- j) Progressive payments and certification

Thus, on the part of sub-contractors, they will need to enhance their knowledge, especially on the discussion on the issues of payment to them, in order to be successful in benefitting the proposed *Construction Industry Payment and Adjudication Act* (CIPA Act).

The purpose of this paper, thus, is to disclose the finding of the third objective of the on-going research. Therefore, it is beyond the scope of this paper to discuss any findings from any of the rest of the on-going research objectives to date.

4. Methodology and Data Analysis

Questionnaires survey was sent to 1,500 sub-contractors throughout Malaysia. However, this preliminary survey analysis was done only the first 50 respondents due to the timeline of the survey is still on-going. Agreement to statements are asked whether there are problems in regard to the existing payment and dispute resolution mechanisms, the adequacy of payment provisions in the proposed *Construction Industry Payment and Adjudication Act* (CIPA Act), the adequacy of adjudication provisions in the proposed *Construction Industry Payment and Adjudication Act* (CIPA Act) and the use of certain provisions on payment remedies for sub-contractors. The 5-level likert scale was used including prevailing the respondent's lack of knowledge on the proposed *Construction Industry Payment and Adjudication Act* (CIPA Act), that is either they are not sure, do not understand or filling blanks.

Forty-four percent (44%) respondents were not sure whether there are problems in regards to the existing sub-contractor's payment and dispute resolution mechanisms. Added to that, six percent (6%) respondents did not filled the required questions whether the use of payment upon certification, direct payment, 'pay when paid', mediation, arbitration and litigation provisions are adequate enough to solve the problems. However, twenty-six percent (26%) agreed with the problems, whereas eight percent (8%) and sixteen (16%) respondents were respectively strongly disagreed and disagreed.

In regards to the payment provisions made in the proposed *Construction Industry Payment and Adjudication Act* (CIPA Act), sixty percent (60%) and six percent (6%) respondents respectively agreed and strongly agreed with the provisions. Only four percent (4%) respondent disagreed that the provisions included in the proposed *Construction Industry Payment and Adjudication Act* (CIPA Act) will solve the sub-contractor's payment problems. However, twenty-four (24%) and six percent (6%) respondents were respectively not sure or did not filled the required questions..

In regards to the adjudication provisions made in the proposed *Construction Industry Payment and Adjudication Act* (CIPA Act), again sixty percent and four percent (4%) respondents respectively agreed and strongly agreed with the provision. There were no disagreement on the provision that will solve problems in sub-contractor's payment and other areas in the construction activities, but twenty-eight percent (28%) and eight percent (8%) respondents were respectively not sure or dis not filled the required questions.

Table 1 shows the level of agreement on various payment remedies for the sub-contractors to benefit from, if they were provided in the proposed *Construction Industry Payment and Adjudication Act* (CIPA Act). There are two parts of payment remedies provided in the table. The first upper part is the provisions

for payment problem prevention and the second bottom part is the provision for problem resolution. These remedies are derived not only catered in the Malaysian Agreements in the construction industry but also avenues which improve the payment problem those have been incorporated in the construction contract or statutes in the other developed countries as well as the proposed *Construction Industry Payment and Adjudication Act* (CIPA Act).

Table 1: Sub-contractors' Level of Agreement on Payment Remedies

Payment Remedies	Did Not Filled	Strongly Disagreed	Disagreed	Not Sure	Agreed	Strongly Agreed
Payment upon certification	8%	0%	6%	16%	40%	30%
Payment of stipulated interest	8%	10%	6%	26%	36%	14%
Suspension of work	8%	12%	16%	12%	40%	12%
Direct payment	8%	0%	0%	10%	46%	36%
Trust funds	10%	4%	8%	22%	46%	10%
Contractor's project account	8%	8%	6%	16%	40%	22%
Payment bonds	8%	8%	8%	18%	48%	10%
Pay when paid	8%	10%	6%	20%	34%	22%
Mechanic liens	8%	8%	8%	40%	28%	8%
Mediation	8%	6%	8%	38%	32%	8%
Adjudication	8%	12%	0%	32%	36%	12%
Arbitration	8%	6%	0%	30%	42%	14%
Litigation	10%	10%	0%	26%	40%	14%

The ranking for the dispute prevention payment problem form the above table is set by the level of agreement that the sub-contractors feels the most suitable provision for them to solve their payment problems. Direct payment from the employer is the most preferred remedies with forty-six (46%) and thirty-six percent (36%) respondents respectively agreed and strongly agreed. This is followed by payment upon certification, contractor's project accounts, payment bonds, pay when paid, thrust funds, suspension of work, payment of stipulated interest, and the least is mechanic liens.

In relation to the resolution mechanism in the case of sub-contractor's payment problems, from the above table, arbitration is still the preferred dispute resolution provision with forty-two percent (42%) and fourteen percent (14%) respondents respectively agreed and strongly agreed. This is followed by litigation with forty percent (40%) and Fourteen percent (14%), adjudication with thirty-six percent (36%) and twelve percent (12%), and mediation with thirty-two percent (32%) and eight percent (8%) respondents respectively.

However, quite a number of percentage are found in the table shows that the sub-contractors is lacking of knowledge on the availability provisions to solve their payment problems. The highest percentage of being either not sure, do not understand or filling blanks is mechanic liens with a total of forty-eight percent (48%) respondents in the payment problem prevention part. This is followed by payment of stipulated interest with a total of thirty-four percent (34%) and thrust funds with a total of thirty-two percent (32%). In the dispute resolution mechanisms, the highest percentage is mediation with a total of forty-six percent (46%) respondents of either not sure or did not filled the required questions. This is followed by adjudication with a total of forty percent (40%), arbitration with a total of thirty-eight percent (38%) and litigation with a total of thirty-six percent (36%).

It is suggested that the sub-contractors need to enhance their knowledge in the available remedies that solve their payment problems. This is to benefit them especially when the proposed *Construction Industry Payment and Adjudication Act* (CIPA Act) is to be implemented. However, in doing so, other avenues that have been implemented in the developed country needs also be analysed whether it is suit the Malaysian construction industry for the benefit of the sub-contractors. However, most of the respondents did agree that the proposed *Construction Industry Payment and Adjudication Act* (CIPA Act) need to be acted soon.

5. Conclusion and Recommendation

Based on the feedback of the survey, it is found that the adequacy of security of payment framework to the particularly small sized sub-contractors needs to be produced. The accepted security of payment framework, though, needs to be of easy to read and understand for its effectiveness in delivering the knowledge. Further to that, the analysis of the various avenues which improve the payment problem in the construction industry those have been incorporated in the construction contract or statutes in the other developed countries as well as the proposed *Construction Industry Payment and Adjudication Act* (CIPA Act), also needs to be done for its effectiveness. However, as long as the Malaysian ‘Security of Payment’ Regime remains in proposal, the sub-contractors have to bear with the current structure of payment mechanisms in the standard forms of contract, which are payment upon certification, direct payment from the employer, and contingent or conditional payment.

Since Malaysia produce a lot of legal cases on payment in the construction contract, this on-going research may introduce the balance and proper ways for the sub-contractor to claim and the main contractor to make the necessary payment. The research may also reduce the present problems on payment in construction contract. This on-going research contents may be very useful to practitioner of both legal and construction contract community as well as the academic students especially to those involves in construction contract management.

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