

STANDARD CONSTRUCTION CONTRACTS IN MALAYSIA

Issues and Challenges

BY

OON CHEE KHENG
BE (Civil), LLB (Hons), MBA,
CLP, MIEM, PEng(M)
Advocate and Solicitor

A paper presented to a seminar on “INNOVATIONS IN CONSTRUCTION CONTRACTS” held on 31 May 2002, Melaka.

1.0 INTRODUCTION

This paper attempts to present a brief overview of the standard construction contracts¹ in Malaysia. It does not however go into details of every aspect of construction contract; instead only selected and salient features will be highlighted. Some questions will be posed, and to some of these attempts are made to answer them; others are left as food for thought. Some insights gained by the writer in drafting two standard construction contracts in Malaysia² will also be used as illustrations.

2.0 THE USE OF STANDARD FORMS

2.1 Standard Forms in Malaysia

There are four institutions and organizations in Malaysia that produce standard forms of construction contracts. These are

- (a) The Institution of Engineers, Malaysia (“IEM”);
- (b) Pertubuhan Arkitek Malaysia (“PAM”);³
- (c) Construction Industry Development Board (“CIDB”); and
- (d) Jabatan Kerja Raya (“JKR”).⁴

IEM has to date produced three standard forms of construction contracts:

¹ The term “construction contracts” is used here to include what are normally referred to as building contracts, engineering contracts and contracts for M&E works. See also John Uff and S. Hughes in H. G. Beale (ed.), *Chitty on Contracts*, (1999) 28th Edition, para 37-002, p. 514.

² IEM Conditions of Contracts for Works Mainly of Civil Engineering Construction (2nd Edition) promoted by The Institution of Engineers, Malaysia (expected to be published and launched in first half of 2003) and CIDB Standard Form of Contract for Building Works-2000 Edition promoted by Construction Industry Development Board, Malaysia which was launched on 13 September 2000.

³ Malaysian Institute of Architects.

⁴ Public Works Department.

- (i) IEM Conditions of Contract for Works Mainly of Civil Engineering Construction;⁵
- (ii) IEM Standard Conditions of Sub-Contract for use in Conjunction with the IEM Conditions of Contracts for Civil Engineering Works;⁶ and
- (iii) IEM Conditions of Contract for Mechanical and Electrical Works.⁷

IEM standard forms essentially are hybrid forms except for the IEM Conditions of Contract for Mechanical and Electrical Works which essentially follows the corresponding FIDIC standard form. The various forms published by IEM, it needs to be appreciated, are the only ones currently for use in private sector civil engineering works and mechanical and electrical works in Malaysia.

The current PAM building contract form is PAM 98 Form which is published in two versions: one with quantities and the other without quantities. PAM 98, as the Form is popularly referred to, is a revised version of PAM 69 Form⁸ which is essentially for most practical purposes a lightly amended version of JCT 1963 Form. PAM 98 aims to update and replace PAM/ISM 69 Form. A PAM 1998 Sub-Contract Form is also produced for use where the sub-contractor is nominated under the PAM 98 Form (with or without quantities).⁹

CIDB has to date produced two standard forms; one is CIDB Standard Form of Contract for Building Works (2000 Edition) and the other is CIDB Standard Form of Sub-Contract for Nominated Sub-Contractor.¹⁰ It is planned by CIDB that a standard form of Design and Build Contract and another for Civil Engineering Contract will also be published. It may be of interest to note that CIDB has also produced a booklet on “Standard Proforma for Contract (*sic*) Administration” which is expressly stated to be used in conjunction with CIDB Standard Form of Contract for Building Works.

JKR has produced a number of standard forms for use in public sector works, both for building works and civil engineering works.¹¹ However, it is observed that the forms are also commonly used in private sector contracts. However, it is not the case that all public sector works follow the PWD 203 variants of contract forms especially those funded by World Bank or Asian Development Bank (for example) where preference seems to be for the adoption of FIDIC Forms.

⁵ Published in May 1989, designated as IEM. CE 1/89.

⁶ Published in May 1990, designated as IEM. CE 1/90.

⁷ Published in 1994, designated as IEM. ME 1/94.

⁸ Or, to be more exact, it should be referred to as PAM/ISM 69 Form.

⁹ See, for further information, Sundra Rajoo, *The Malaysian Standard Form of Building Contract* (1999) Second Edition, pp. 7-13 on the making of PAM 98 Form.

¹⁰ The CIDB Sub-Contract Form, officially designated as “Form CIDB.B(NSC)/2002” is expressly stated to be for use in conjunction with the CIDB Standard Form of Contract for Building Works. It was launched on 13 May 2002.

¹¹ Each of which is designated as PWD 203 with different letters that follow to distinguished each from the other for various forms.

2.2 Inherent Philosophy and Assumptions in Standard Forms

In order to properly appreciate the problems, even the strength, of the use of standard forms of contract, an understanding of their underlying philosophy and assumptions is of immense importance.

(a) Independent certifier

Construction contracts differ from other commercial contracts in that, other than the parties to the contracts themselves, i.e. the Employer and the Contractor, there is a third person who features prominently throughout. This third person is variously referred to as “the Engineer” in IEM standard forms, the “the Architect” in PAM forms and “the Superintending Officer” or “S.O.” in PWD and CIDB forms. In fact, it is the case in all standard forms that, upon the execution of the contracts, the Employer hardly plays any role other than payment, and is limited to have some say on matters relating to termination of employment and others.

The law with respect to the required independence of the contracts administrator in his role as a certifier, and the consequence of the non-independence and impartiality of the certifier, is generally well understood.¹² It needs to be appreciated that it is the duty and role played by the contracts administrator which matters, not on who employs him and certainly not in his other role where he is empowered to exercise his discretion. The potential problem lies when the contracts administrator when he is playing, or is entrusted with the role of, a certifier who lacks impartiality. This is the type of complaint, mainly, from contractors whose complaints are, not infrequently, not without justification. If the complaints are justified, or proved, either in litigation or more frequently for construction contracts, arbitration, the certificates are void. However, the question which is often asked is this, must the victim of such partiality, frequently the Contractor, sometime the Employer, wait for an arbitrator’s award or a court judgment to see wrongs be corrected?

(b) Equality of bargaining power

The concept of inequality of bargaining power, though not an express provision in Contracts Act 1950, is nevertheless a recognized principle of English common law¹³ which is highly persuasive in Malaysia.¹⁴ Though it seems highly unlikely that a construction contract entered into between two commercial organizations can be declared void on this ground alone, it is

¹² See for example, *Hickman & Co v. Roberts* [1913] AC 229, *P and M Kaye v. Hosier and Dickinson* [1972] 1 All ER 122.

¹³ See, for example, *Lloyds Bank Ltd v. Bundy* [1975] 1 QB 326.

¹⁴ Indeed the Court of Appeal (*per* Gopal Sri Ram JCA) has recently affirmed emphatically that Malaysian law does recognize a general doctrine of inequality of bargaining power in the important case of *Saad bin Marwi v. Chan Hwan Hua & Anor* [2001] 2 AMR 2010.

nevertheless the case that, especially in depressing economic environment, that there is one party, not infrequently the Employer, who is in a position to dictate the terms of the contract. The problem for standard construction contracts is that it is assumed that the two parties on both sides of the contracting fence are of equal bargaining position.

(c) Consensus approach

It is an underlying assumption that a contract produced and promoted by a professional institution must necessarily be “equitable” and provides a balanced allocation of risks and that the legitimate interests of the various parties in the construction industry¹⁵ are well protected. There was wide consultation of various players in the construction industry during the drafting the CIDB Forms even though CIDB is not a professional institution.¹⁶ This is certainly the case which all standard forms of contracts in Malaysia can claim,¹⁷ with the possible exception of PWD 203 Forms, with varying degrees of justification.

(d) Non-consideration of tendering exercise

The standard forms as drafted do not take into consideration the implications of tendering exercise and its legal implications on the legality and enforceability of the conditions therein provided. One good example is the equivalent of clause 12 of FIDIC Form for Civil Engineering Works where it is provided that the Contractor is deemed to have inspected the site and to ascertain the conditions of the subsoil etc. The problem with this is that the tenderer is only given a very short time to complete and submit the tender for projects which are large in area and extensive in length.¹⁸

2.3 Some Problems with Using Standard Forms

The use of standard forms is not without its advantages. For example, a tenderer when faced with a familiar contract, can dispense with seeking legal advice and incur some cost saving and speed up the tendering exercise compared with the case for unfamiliar contract. The widespread use of standard forms can also be used as a gauge of the market prices for a certain construction items, products or processes. It can be that the use of some standard forms is so widespread and common that it can be regarded as a form of “private legislation”.¹⁹ The use of standard form is however not without its problems some of which are briefly discussed below.

¹⁵ That is, this includes more than the two parties to the contract.

¹⁶ It is a statutory organisation set up pursuant to section 3 of Construction Industry Development Board Act, 1994 (Act 520).

¹⁷ One notable exception across the causeway is SIA 80 drafted by I.N. Duncan Wallace QC which expressly rejects the consensus approach. It is widely held, perhaps rightly so, that SIA 80 leans very much to the interests of the Employer.

¹⁸ See for example the case of *Boyd & Forest v. Glasgow & South Western Railway Co* [1915] AC 526.

¹⁹ For example on the use of JCT Forms in England.

(a) Amendments made to Standard Forms

Most drafters of standard forms of contracts will advise against making amendments to standard forms²⁰ but the writer's experience is that amending standard forms seems to be the norm rather than the exception. The reasons for this are many and it seems that this is sometimes the initiative of the architect, engineer or quantity surveyor's firms that prepare the contract documents. The Employer's specific requests can also be a reason. Whatever the reason for making the amendments, the resulting document can be disastrous and can often have the unintended result which the parties may never have contemplated and the full contractual implications do not seem to be considered. For example, in the case of *Balfour Beatty Civil Engineering Ltd v. Docklands Light Railways Limited*,²¹ two major amendments were made to the standard ICE Conditions of Contract 5th Edition; one substituting "Engineer" with "Employer's Representative" and the other removing the power of the Arbitrator to "open up, review and revise" certificates. The question which arose was if the court had the power to "open up, review and revise" certificates issued by the Employer's Representative. The court held that it had no such power!²² The effective consequence of the two amendments was that the certificates of the Employer's Representative became final and binding on both parties as neither the court nor the arbitrator had the power to revise them.

Another consequence of making amendments to standard forms of contracts is that it makes the construction of the contracts a real nightmare. Inconsistencies abound and the varying interpretations are a fertile source of disputes, and possibly the consequence to the two contracting parties is that millions of ringgit may be at stake.

(b) Contract Documentation

The various parts of a contract are, more often than not, prepared by different firms or even by different professionals within the same firm. For example, the drawings and the specifications are prepared by the Architect or the Engineer (of civil, electrical, mechanical geotechnical or structural disciplines) whereas the methods of measurement and the bills of quantities are prepared by the Quantity Surveyor. This, it is submitted, is another source of disputes as invariably contradictions will creep in and ambiguities will surface when the different documents forming the contract are subject to scrutiny.

²⁰ See for example Sundra Rajoo, *op. cit.* p. 12

²¹ (1996) 78 BLR 4.

²² It is to be noted that this decision was handed down before the landmark House of Lords' decision in *Beaufort Development Ltd v. Gilbert-Ash Ltd* [1998] 2 All ER 778 which overrules *Balfour Beatty*.

(c) Contracts Administration

It is the writer's experience, and through exchanging notes with other construction law practitioners and arbitrations, that many construction disputes can be avoided if the contracts have been properly and professionally administered. It is unfortunately the case that in engineering and architecture schools, this aspect of practice has not been given emphasis, and very often engineers and architects were thrust into the role for which they are ill prepared. Construction projects are commercial enterprises involving possibly substantial sum of investment by parties on both sides of the contracting fence and nothing less than professional contracts administration should suffice. May be it is time that a new breed of professionals can surface who can play the role of, and function as, professional contracts administrators.

2.4 Non-Standard Forms

The becoming construction industry in Malaysia from the late eighties to 1997 has seen many mega projects being implemented and in many of these, contracts have been drafted to tailor suit the particular need and desires especially of the promoters of the projects. These projects include Kuala Lumpur International Airport, Putrajaya, Projek Lebuh raya Utara-Selatan (PLUS) and others. Some common features of these contracts are that the allocation of risks are very much inclined in favour of the Employer, professionals are answerable to what are known as the Employer's Representative and others. These contracts more often than not are substantially and extensively amended versions of FIDIC Standard Forms.

What has been discussed above is an overview of the use of standard construction contracts in Malaysia. What follow below is a discussion of some aspects of standard construction contracts.

3.0 PERFORMANCE SECURITY

The various IEM Standard Forms and PWD 203 Forms require the submission of a performance bond by the Contractor.²³ PAM 98 does not require the submission of a performance bond but, from the writer's experience, there is invariably a provision in the letter of award (which is expressed to be part of the contract) or in the bills of quantities (in what is called "Preliminaries") that requires its submission. In the CIDB Form, the requirement for the submission of performance bond is optional.²⁴ In PWD 203 Forms, this is required *via* Clause 37.

It however has to be borne in mind that a performance bond is itself a separate

²³ Clause 37 for IEM. CE 1/89 Form, Clause 23 for IEM. ME 1/94 Form, Clause 24 for IEM. CES 1/90 Form, and Clause 37 of PWD 203 Form.

²⁴ Option Module F.

contract between the financial institution providing the bond²⁵ and the beneficiary of the bond, who is of course the Employer. The current development of the law relating to making a call or demand on a performance bond is that the bond will be construed strictly on the face of it.²⁶ Currently the wordings of most performance bonds are such that they fall into the category of what used to be called “on demand” bonds and no questions needs to be asked save for the question of fraud before the bond is honoured when a call or demand is made and an injunction to stop it is unlikely to succeed.²⁷ The trouble for the contractor is that many times when a dispute develops, a call on the bond is made, rightly or wrongly. The contractor can only resort to either arbitration or litigation for his remedy. However, the contractor’s credit worthiness in the eyes of the bank or financial institution is as a consequence suffered. One consolation for the contractor is the Malaysian High Court decision of *The Radio & General Trading Co. Sdn Bhd v. Wayss & Freytag (M) Sdn Bhd*²⁸ which imports the concept of unconscionability in preventing an inequitable call of the bond.²⁹

A performance bond is usually provided by the Contractor with the un-stated reason that this is to ensure, or compel, the performance of the Contractor’s obligations under the contract. This is illustration of the inequality of bargaining power of the two parties to a construction contract for, much as there is a possibility of the Contractor not fulfilling his obligation, there is also a possibility of the Employer not fulfilling his obligation to pay the Contractor. And, usually, the Employer is not required to provide a bond to the Contractor to guard against his non-performance! CIDB recognizes this commercial tussle and has made the submission of performance bond by the Contractor, and the submission of the payment bond³⁰ by the Employer, options at the election of both parties in the published CIDB (2000). However the effectiveness of this gesture in restoring some equality to the contracting scene remains to be seen as the CIDB (2000) is to date relatively untested.

4.0 EXTENSION OF TIME AND LIQUIDATED DAMAGES

Time is one of the three important criteria of judging the success or otherwise of a construction project.³¹ And a construction dispute very often involves the question of time, and the cost consequent to it. This is a large topic and there is a considerable literature devoted to this complicated subject.³² This paper shall only

²⁵ This can either be a bank or an insurance company.

²⁶ See *IE Contractors Ltd v. Lloyds Bank Plc* (1990) 51 BLR 1, followed in Malaysia in *Teknik Cekap Sdn Bhd v. Public Bank Bhd* [1995] 3 MLJ 449.

²⁷ See, for example, *Transfiled Projects (M) Sdn Bhd & Anor v. Malaysian airlines System Bhd* [2000] 7 MLJ 583.

²⁸ [1998] 1 MLJ 346.

²⁹ See a discussion of *Wayss & Freytag* in J. Arthur McInnis, “Equity in Construction Law-New Malaysian Directions” (2000) 27 JMCL 269.

³⁰ Option Module E.

³¹ The other two are cost and quality.

³² For a detailed discussion of these topics, see Brian Eggleston, “Extension of Time and Liquidated Damages in Construction Contracts” (1997) Second Edition, and Keith Pickavance, “Delay and Disruption in Construction Contracts” (2000) Second Edition.

confine itself to some salient features of extension of time and liquidated damages provisions in standard construction contracts. All standard forms in Malaysia contain a provision for extension of time to the completion date and a liquidated damages clause in case of delayed completion by the Contractor.³³

4.1 The Requirement to Serve Notice

All the provisions for extension of time required the Contractor to serve a notice prior to the Architect/Engineer/S.O. granting the same. The question that is often asked is, what if the Contractor fails to serve the required notice? Or he has served it out of the time stipulated in the provision of the contract?

The trouble with finding an answer to this question is that the exact time when the submission of such a notice is required is rather difficult to ascertain. For example in PAM 98 it is provided that

“If and when it becomes *reasonably apparent* that the progress of the Works is being or is *likely* to be delayed beyond the Date for Completion the Contractor *shall forthwith* of the occurrence of such event notify the Architect in writing ... giving ... an estimate of the extension of time required.”³⁴ (emphasis supplied)

With the use of duty imposing word “shall” and the urgency of the submission is highlighted with the word “forthwith”, it is nevertheless subject to the time when it becomes *reasonable apparent* to the Contractor that the Date for Completion is *likely* to be delayed. It is a case of making a definite time subject to another which is rather elastic!

It is true that in JCT Forms (1963) and likely in PAM 98 Form³⁵, the service of a notice is not mandatory in that failure to serve the required notice *per se* is not fatal to the Contractor’s rightful entitlement³⁶, the fact is that this has not prevented many Architects from failing to grant extension of time in the absence of a notice.

It may be interesting to note the provision of Contracts Act 1950 where it is provided that:

“Every agreement, by which any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract, or *which limits the time within which he may thus enforce his rights, is void to that extent.*”³⁷ (emphasis supplied)

³³ Clauses 43 and 40 respectively for IEM. CE 1/89, Clauses 26 and 27 respectively for IEM. CES 1/90 and Clause 31 for IEM. ME 1/94; Clauses 23 and 22 respectively for PAM 98; Clauses 24 and 26 respectively for CIDB (2000); and Clauses 43 and 40 respectively for PWD 203 Forms.

³⁴ Clause 23.1 PAM 98. The substantially same wordings are also found in Clause 43 of IEM. CE 1/89 and Clause 43 of PWD 203 and to a lesser extent Clause 24.2 of CIDB (2000).

³⁵ See however commentary to the contrary in Sundra Rajoo, *op. cit.* p. 207.

³⁶ *London Borough of Merton v. Stanley Hugh Leach Ltd* (1985) 32 BLR 51.

³⁷ Section 29 Contracts Act 1950.

It may be interesting to note the outcome if the requirement to serve notice is challenged in a Malaysian court by way of section 29 Contracts Act 1950.

4.2 Quantum of Time Extension and its Computation/Determination

Granting extension of time is both a qualitative and a quantitative process. To judge if a contractor is entitled to extension of time is a qualitative process in the sense that the Architect/Engineer/S.O. has to decide if the delaying event falls within the grounds which the Contractor is so entitled to an extension besides other preliminary considerations. The next step will be to determine quantum of the extension if it is decided that the Contractor is so entitled.

All the standard construction contracts in Malaysia do not contain any provision imposing on the Architect/Engineer/S.O. the method of determining the quantum of such an extension. For example, PAM 98 requires the Architect to give an extension of time which if “fair and reasonable”³⁸. The same goes for IEM. CE 1/89 and PWD 203.³⁹ CIDB (2000) Form obligates the S.O. to grant an extension of time which “may reasonably reflect delay in completion of the Works”.⁴⁰

There has been considerable literature and even debate on the methodology of determining the quantum of extension which the Contractor is entitled.⁴¹ Some advocate the use of critical path method and computer programs have been developed to aid the contracts administrator in this regard and some use the bar chart as a basis of determination.⁴² There are even Architects/Engineer/S.O.’s. who use what may be called rule of thumb. The only commonly agreed conclusion which can be reached is that there is no consensus on the use of any methodology.

Determining or computing the quantum of extension is a complex process and it is suggested that it may not be possible to put in words a definitive method of accomplishing this. The latest effort of Society of Construction Law in this direction is a step forward and may contribute to the improvement in the drafting of standard forms of construction contracts but this however remains to be seen.⁴³

As stated, extension of time provision is always present in a standard construction contracts. However, it may be that there is a situation when the Employer, with the concurrence of the Contractor (and possibly with agreed extra consideration), bring

³⁸ Clause 23.3, PAM 98.

³⁹ Clause 43 of both IEM. CE 1/89 and PWD 203 Forms.

⁴⁰ Clause 24.1.

⁴¹ See, for example, Tony Farrow, “*Delay Analysis – Methodology and Mythology*” (2001), a paper based on talk given to a meeting of the Society of Construction Law on 6 November 2001.

⁴² See, for example, Keith Pickavance, “*Principles and Policies in Delay Analysis*” (2001), a paper presented to Society of Construction Law on 6 February 2001.

⁴³ Society of Construction Law, “*Protocol for Determining Extensions of Time and Compensation for Delay and Disruption*” (Consultation copy November 2001, revised version May 2002, final version October 2002).

forward the Date for Completion. Why there should not be a provision in a standard construction contract to this effect is hard to refute.⁴⁴

4.2 Liquidated Damages

Liquidated damages in Malaysia is a misnomer for, pursuant to the provisions of section 75 Contracts Act 1950 such compensation⁴⁵, by whatever name so called⁴⁶, is essentially the equivalent of penalty in English law.⁴⁷ Further, and despite what is the position in English law and the express provisions of section 75 Contracts Act 1950, the non-defaulting party will have to prove what loss he has suffered before he is entitled to compensation by way of what is called in the contract “liquidated damages”.⁴⁸ PAM 98 has made an attempt in circumventing *Selvakumar*⁴⁹ but it is the opinion of this writer that it may not be a successful attempt. The drafting committee of CIDB (2000) after much deliberation and debate has decided to follow the traditional wordings and let the law take its own natural course.

5.0 VARIATIONS⁵⁰

5.1 The Concept of Variations

The concept of variation is simply this: the Contractor has been given a certain price to execute and complete a certain work and what is not covered for in that price is a variation to the contract. Here comes the difficulty: how is one to determine if a certain work is or is not covered within the price already contracted for? The answer to this question will also directly answer the question if the work is a variation to the contracts.

It is frequently said, correctly no doubt, that work which is incidental to the work already contracted for is within the scope of the Works and is thus not a variation. Other phrase used is “indispensable and/or necessary work”.

The main problem, it is submitted, is that standard forms of contract often prescribe what *can be* variations but not what *ought to be* variations.⁵¹ To determine if a certain instruction⁵² gives rise to a variation or a certain work is a variation is an exercise which one has to glean from a study of the whole contract comprising

⁴⁴ The draft IEM conditions of Contract for Works Mainly of Civil Engineering Construction, 2nd Edition has a provision to this effect.

⁴⁵ Contracts Act 1950 does not use the word “damages” but instead the word “compensation” is used throughout.

⁴⁶ It may be worthwhile to note here that there is no distinction between liquidated damages and liquidated and ascertained damages.

⁴⁷ See *Chung Syn Kheng Electrical Co. Bhd v. Regional Construction Sdn Bhd* [1987] 2 MLJ 763.

⁴⁸ As held by Peh Swee Chin FJ in *Selvakumar v. Thiagarajah* [1995] 2 MLJ 817 and followed by the Court of Appeal in *Reliance Shipping & Travel Agencies v. Low Ban Siong* [1996] 2 MLJ 543.

⁴⁹ See Clause 22.2 of PAM 98.

⁵⁰ For a discussion on this topic, see Peter R. Hibberd, “*Variations in Construction Contracts*” (1986).

⁵¹ See for example Clause 23(a) of IEM. CE 1/89, Clause 11.1 of PAM 98, Clause 1.1 of CIDB (2000) and Clause 24 (b) of PWD 203.

⁵² Assuming that the instruction is validity issued.

possibly conditions of contract, drawings, specifications, bills of quantities and standard methods of measurement. It is this that gives rise to uncertainties and possible disputes especially contradictions between the various documents constituting the contract. Further, there is the problem of unforeseen site conditions and conditions of the subsoil and the construction of what may be the different variants of Clause 12 of FIDIC/ICE conditions on contract.⁵³

5.2 The Jurisdictional Problems

There seems to be some confusion if it is a *duty* of the Architect/Engineer/S.O. who is to issuing a variation or he has the *power* so to do. For example, in IEM CE.1/89, both the duty imposing word “shall” and discretion conferring word “may” is used within the same clause.⁵⁴

It is however generally accepted that it is a *power* of the Architect/Engineer/S.O. to issue instructions and he is not under a duty to do so. The implication of this is that as a power, it is capable of being delegated. Therefore, if the power to issue instructions is properly delegated, the Engineer’s or the S.O.’s Representative can also issue an instruction requiring a variation.⁵⁵

Other than what has been outlined in the preceding paragraph, the limit of the Architect’s/Engineer’s/S.O.’s jurisdiction to issue instructions requiring variations can stem from monetary limit, geographical limit and limit imposed by the variation clause itself. It is often the case that an Architect’s/Engineer’s/S.O.’s power to issue instructions requiring variations is limited because of monetary limit. The geographical limit of an Architect’s/Engineer’s/S.O.’s to issue instructions requiring variations can be inferred by the definition of “the Work” which is to be constructed within “the Site”: for example it would be *ultra vires* the power of Engineer in IEM. CE 1/89 Form if the Engineer were to issue a variation to extend a highway project by an extra kilometer. Further, as for the case of ICE Conditions of Contract 5th Edition, the variation work must be “necessary for the completion of the Works”. An illustration of the last jurisdictional limit can be seen in the case of *Blue Circle Industries PLC v. Holland Dredging Company (UK) Ltd*⁵⁶ where it was held by the Court of Appeal that an instruction to transport dredged materials to create an island would not amount to a variation as this was not necessary for the completion of the Works. Two implications of an instructed additional work which is not a variation are, firstly, that the valuation mechanism within the contract itself needs not apply and, secondly, the Contractor can elect not to implement that instruction.

During the drafting of CIDB (2000), this aspect has been considered and what can be variation (in the form of the definition for variation) has been drafted very

⁵³ Such as Clause 14 of IEM. CE 1/89 and Clause 15 of PWD 203. There is no similar or equivalent provision in PAM 98 and CIDB 2000.

⁵⁴ Clause 23 (a). See also Clause 51(1) of ICE Conditions of Contract 5th Edition.

⁵⁵ Note however there is no such a person as an Architect’s Representative in PAM 98.

⁵⁶ (1987) 37 BLR 40.

widely and no jurisdictional limit as outlined above has been imposed, except possibly the geographical limit.

5.3 Method of Measurement

The use of a method of measurement is not without its advantages, and disadvantages.⁵⁷ However, in Malaysia, there has been to date no standard method of measurement for civil engineering works.⁵⁸ The Institution of Surveyors, Malaysia has developed a standard of measurement for building works. To this, the advice of Lord Pearson in his speech in the case of *Farr v. Ministry of Transport*⁵⁹ should be heeded:

“I think it is strictly correct to say that clause 57 does not impose on the building owner an obligation to draft his Bill of Quantities in conformity with the Standard Method of Measurement, but it would be natural and advisable for him to do so ...”⁶⁰

Other than CIDB (2000) which refers to the “Malaysian Standard Method of Measurement of Building Works”⁶¹ and PAM 98⁶² none of the other standard forms discussed herein makes reference or incorporates a method of measurement. One important point to note is that one should resist the temptation of using method of measurement to determine the scope of the Works and scout for a possible “lacuna” to pursue a variation claim.⁶³

6.0 PAYMENT PROVISIONS

The question of payment is a controversial one, and one which relates to the very central issues which have been discussed so far. Accordingly, only a few selected issues will be discussed here. The issue of Employer’s payment bond has been discussed above and will not here be repeated.

6.1 “Pay when Paid” and “Back to Back”

This is relevant especially in the case of nominated subcontractor when the main contractor has not been paid by the Employer. In most non-standard construction contracts encountered by the writer in his practice, this is also invariably the case.⁶⁴

⁵⁷ See I. N. Duncan Wallace, “*The Use of Bills of Quantities in Civil Engineering and Building Contracts*” in “*The ICE Conditions of Contract 5th Edition*” (1978), pp. 305-316 which contains a thought provoking discussion on the use of method of measurement.

⁵⁸ The one currently developed by CIDB and to which the writer is associated should be published during the second half of 2003 and is modeled along CESMM 3.

⁵⁹ (1977) 5 BLR 94.

⁶⁰ *Ibid*, p. 116.

⁶¹ Clause A4, Option Module A.

⁶² Clause 12.1.

⁶³ See *Farr v. Ministry of Transport* cited above, especially the speech of Lord Guest on p. 114.

⁶⁴ In many of these, the wordings are simply “This subcontractor shall be back-to-back with the Main Contract” which are, simply put, meaningless and are unlikely to have their intended effect.

Why this should be so is hard to comprehend especially if this is viewed from the perspectives of the lower-tier contractors. It may be worthwhile to note that in England, this type of provision in construction contracts have been rendered unenforceable.⁶⁵ During the drafting of CIDB (2000), the policy of pay when paid was also rejected in the case of payment from the Contractor to the Nominated Subcontractor.⁶⁶ The security of payment by the Contractor to the Nominated subcontractor is however enhanced in CIDB (2000), as provisions are included to the effect that certificates of payment with respect to the Nominated Subcontract Works alone shall be issued by the S.O. to both the Contractor and the Nominated Subcontractor.⁶⁷

6.2 Remedies for Non-Payment

Perhaps the question which troubles a contractor most now is the question of non-payment or delayed payment by the Employer. All the standard forms discussed herein with the exception of PWD 203 contain a provision that if the Employer does not pay, the Contractor is entitled to bring the contract, of his employment under contract, to an end.⁶⁸ Proper procedure must however be followed.⁶⁹

However terminating a contract is often viewed to be a serious step to adopt and, from a commercial viewpoint this may not be desirable and conducive for possible settlement. Most businessmen will also fear that if this step is resorted to, their rightful entitlement may be “stuck” for years and can only be recovered after a successful foray into arbitration or litigation. Such a fear is not without justification for any businessmen will appreciate the importance of cash flow to the going concern and health of an enterprise.

One possible remedy to this obvious breach of contract by the Employer in not paying, or not paying on time, is to allow the Contractor to claim for interest.⁷⁰ This affords some relief to the Contractor but this can be a double-edged sword for the Contractor for it effectively allows the Employer to suspend payment and not commit a breach of contract!

Another remedy which the Contractor can resort to is to suspend further performance of his obligations under the Contract. This can be a safe position taken by the Contractor and is in fact one routinely taken by the Contractor when non-payment from the Employer ensues. The problem with taking this position is that in the absence of a contractual provision to this effect, there can be no unilateral suspension of work: two wrongs do not make a right!⁷¹ Though there are persuasive

⁶⁵ Section 113 of Housing Grants, Construction and Regeneration Act 1996.

⁶⁶ Clause C3 (c), Option Module C.

⁶⁷ On the strength of the Federal Court’s decision in *Pembinaan Leow Tuck Chui & Sons Sdn Bhd v. Dr. Leela’s Medical Centre* [1995] 2 MLJ 57 which held that the Employer could not set-off from the amount due in a certificate for works which had been duly certified; the Contractor was also entitled to summary judgment of the amount due.

⁶⁸ Clause 52(a)(i) of IEM. CE 1.89, Clause 26.1(i) of PAM 98 Clause 45.1(a)(i) of CIDB (2000).

⁶⁹ See the Singapore case of *Central Provident Fund Board v. Ho Bock Kee* [1981] 1 MLJ 80.

⁷⁰ Clause 42.9(b) of CIDB (2000).

⁷¹ *Channel Tunnel Group Ltd v. Balfour Beatty Construction Ltd* [1992] 1 QB 656.

Academic writings arguing for allowing such a suspension,⁷² the fact remains that this is currently not the established law. It is against this background that CIDB (2000) provides a contractual right to the Contractor to suspend his execution of the Works if he breaches his payment obligation.⁷³

CIDB (2000), thus, in contrast to other standard forms in Malaysia, provides additional security to the Contractor in case of non-payment by the Employer. This triple mechanism of interest, suspension and determination, together with a demand made on the payment bond (if Option Module E is adopted) go a longer way compared to all other standard forms in Malaysia in providing greater security to the Contractor in securing payment and thus make CIDB (2000) a more equitable contract in the process.

It is a case that you cannot make everybody happy: there is a move from some quarter in Malaysia to introduce the concept of “lien” as a further payment security for the Contractor. This course of action is not recommended, as its effectiveness seems very much in doubt⁷⁴, besides its legality in the Malaysian context.

In some countries and states, the legislature has intervened to enhance security of payment for the contractors: for example in New South Wales, Australia, there is Building and Construction Industry Security of Payment Act 1999 (No. 46); in United Kingdom there is Housing Grants, Construction and Regeneration Act 1996 (together with The Scheme for Construction Contracts (England and Wales) Regulations 1998; the proposed Construction Contracts Bill 2001 in New Zealand; Builders’ Lien Act in Alberta, Canada and others.

6.3 Retention Monies

All the standard forms of construction contracts discussed herein with the exception of PWD 203 contain a provision for the Architect/Engineers/S.O. to certify the retention of a certain percentage of the amount certified.⁷⁵

All the three standard forms import the concept of trust in dealing with the legality of the monies retained. The purported aim of such a retention fund is to function as a form of security to the Employer in respect of possible defective work. The trust concept also “protects”⁷⁶ the Contractor against the monies being ranked as an unsecured debt if the Employer becomes insolvent.

A few criticisms can be leveled against this import of the trust concept in a contractual context.

⁷² See, for example, J.W. Carter, “*Suspending Contract Performance for Breach*” in Jack Beatson and Daniel Friedmann (eds.), “*Good Faith and Fault in Contract Law*” (1995), pp. 485-522.

⁷³ See Clause 42.10 of CIDB (2000).

⁷⁴ See Martin Odams, “*The Mechanics’ Lien: Its Nature and Significance to the Construction Industry*” in Martin Odams (ed.), “*Comparative Studies in Construction Law: The Sweet Lectures*” (1995), pp. 257-276.

⁷⁵ Clause 47(e) of IEM. CE 1/89, Clause 30.4 of PAM, and Clause 42.3 of CIDB (2000).

⁷⁶ Though contractors will very much prefer that no sum be retained and hence no “Protection” in this way!

Firstly, a trustee must not be in a position where there would be a conflict of interest. However, the Employer, being the trustee of the Retention Fund,⁷⁷ is permitted draw on the Fund for himself⁷⁸: he is a thus a trustee and also at the same time a possible beneficiary of the trust created!

Secondly, it may be that as drafted the co-called trust created may not be validly constituted for a lack of certainty of subject matter. In the provisions as drafted, it is impossible to distinguished between what is trust fund and what is the Contractor's entitlement.

Thirdly, there is no security to the Contractor if no monies have been set aside and the security of the Contractor is at risk if, assuming a validity constituted trust is possible, the Employer becomes insolvent. CIDB (2000) provides an elaborate set of rules to guard against this⁷⁹ such as the creation of a separate bank account but it is still difficult to ascertain if this is effective.

One final question that needs to be posed is this: Does the Employer really need the Retention Fund to guard against defective works when he already has the performance bond? Further, if the defects are structurally, functionally and aesthetically acceptable, the Employer can always deduct a certain amount as diminution in the value of the Works⁸⁰. The ground is thus laid to question the desirability of the retention trust concept, and the concept of retention itself as a security against defective construction.

7.0 DETERMINATION/TERMINATION

All the standard forms on contracts discussed herein with the exception of PWD 203 forms contain provisions for *both* the Employer and the Contractor to terminate the contract, or, to be more exact, for the Employer to determine the employment of the Contractor under the contract and for the Contractor to determine his own employment.⁸¹ The discussion herein will only relate to two aspects of the issue.

A serious point of contention when the determination of employment occurs is this: what is the value of the Works executed by the Contractor up to the point of the determination? In the experience of the writer, this issue, if argued before an arbitrator, is both time consuming and may detract attention from the real issues in dispute between the two parties. In an attempt to solve this issue, CIDB (2000) has

⁷⁷ The term "Retention Fund" is used in IEM. CE 1/89 and PAM 98 whereas the term "Retention Monies" is used in CIDB (2000).

⁷⁸ Clause 47(f)(i) in IEM. CE 1/89, Clause 30.5(ii) of PAM 98, and Clause 42.3(c)(iii) of PWD 203.

⁷⁹ Clause 42.3 (c)(ii),(iii), and (iv) of CIDB (2000).

⁸⁰ See *Ruxley Electronics and Construction Ltd v. Forsyth* (1995) 73 BLR 1, also Clause 27.4 of CIDB (2000).

⁸¹ Clauses 51 and 52 respectively for IEM. CE 1/89, Clauses 25 and 26 respectively for PAM 98 and Clauses 44 and 45 respectively for CIDB (2000). PWD 203 Forms only contain provisions for the Employer to determine the employment of the Contractor under the contract: Clause 51.

provided that the S.O. has to issue a certificate⁸² certifying the works completed by the Contractor up to the day when the determination occurs.

The second issue to be highlighted is this: none of the contracts with the exception of CIDB (2000) provides for the situation when the Employer wishes to terminate the contract in the absence of any default of the Contractor. Why this should not be allowed if the Employer or the Contractor senses something amiss (probably not of their doing) and the Employer wishes to amicably bring the parties' contractual relationship to an end? That legally this is possible can be seen from the Malaysian case of *Bains Harding (Malaysia) Sdn Bhd v. Arab-Malaysian Merchant Bank Bhd & Others*.⁸³ CIDB (2000) has broken new ground with a provision to this effect.⁸⁴ The point to stress here is that it would be preferable if the decision to terminate the contract were a *mutual decision* of both the Contractor and the Employer and is not one which is imposed by one party onto another.

8.0 DISPUTES RESOLUTION

All the standard forms discussed herein provide for arbitration as a means of dispute resolution.⁸⁵ Out of these, only PAM 98 and CIDB (2000) provide for a mediation alternative; however in the case of CIDB (2000) the mediation is compulsory and the disputing parties must attempt to resolve any dispute between them by mediation first before arbitration is resorted to whereas in PAM 98, the resource to mediation is an option available to the parties.⁸⁶

The use of mediation is not without its detractors⁸⁷ and, in Malaysia, there is additional problem of an acute shortage of *experienced* mediators.⁸⁸

The perceived advantages, and disadvantages, of arbitration are well documented and it is not suggested that these be considered here. However in all arbitration agreements⁸⁹ in the standard construction contracts, there are provisions to the effect that an arbitral reference can only commence after the completion or alleged completion of the Works. It is to be appreciated that in some situations this is not either of both the parties to the contract. It is for this reason that the writer advocates the use of (contractual) adjudication and for a construction contract to incorporate a provision to this effect.

⁸² Called in CIDB (2000) as a "Certificate of Termination Cost" by virtue of Clause 44.4.

⁸³ [1996] 1 MLJ 425

⁸⁴ Clause 46 of CIDB (2000), however the clause only gives the right to the Employer to terminate the Contract in the absence of any default of either party.

⁸⁵ Clause 55 for IEM. CE 1/89, Clause 34 for PAM 98 and Clause 47.3 for CIDB (2000) and Clause 55 for PWD 203.

⁸⁶ Clause 35 for PAM 98 and Clause 47.2 for CIDB (2000).

⁸⁷ See, for example, G. Tillett, "*The Myths of Mediation*", The Centre for Conflict Resolution, Macquarie University, New South Wales, Australia (1991).

⁸⁸ Though CIDB has made a start by training and accrediting construction industry mediators.

⁸⁹ The respective arbitration clauses.

One other point that should not be left untouched is that in some standard forms of contract, reference of the dispute or difference must first be referred to the Engineer/S.O. for a final decision before one can resort to arbitration.⁹⁰ There are two objections to this.⁹¹ Usually and in practice if the stage is reached where one party feels compelled to resort to arbitration, the Architect/Engineer/S.O. for a final decision, the arbitrator may lack jurisdiction to publish an award which includes this dispute or difference.

One final point can be made. Mediation, adjudication and arbitration are means of *resolving* disputes, not means of *avoiding* dispute. There are other methods of (alternative) dispute resolution which may be worth considering.⁹² It may be time for standard construction contracts to look to this direction. Partnering is frequently mentioned as a means of dispute avoidance but this is not without its pitfalls.⁹³

9.0 CONCLUSION

The use of standard construction contracts is not without its advantages. However, the limitations and the philosophy inherent in the standard construction contract adopted must be well appreciated. One possible disadvantage of the prevalent use of standard construction contracts is that this inhibits thinking and new developments and ideas which are not reflected in the standard construction contract adopted are through ignorance not considered. This paper has attempted to discuss some features of standard construction contracts and has also tried to highlight certain innovations in and beyond some standard construction contracts which draftsman of construction contracts may wish to have them for consideration.

© Oon Chee Kheng
29.05.2002 @ 0149
25.10.2002@ 0334 (Slightly revised)

⁹⁰ See for example, Clause 55(a) of IEM. CE 1/89, Clause 54 (a) of PWD 203 and Clause 47.1 of CIDB (2000).

⁹¹ The Draft IEM Conditions of Contract for Civil Engineering Works, 2nd Edition has excluded this final reference to the Engineer.

⁹² For an overview of the various methods, see John Tyrill, “*Construction Industry Dispute Resolution – A Brief Overview*” (1992) 3 ADRJ 167.

⁹³ See, for example, John Dorter, “*Implications of Partnering for Mining and Construction*”, (1996) 12 B.C.L. 174 – 211.