

# CONTRACTOR'S DILEMMA IN SUSPENDING WORKS AGAINST NON-PAYMENT IN CONSTRUCTION INDUSTRY: HIGHLIGHTING POSSIBLE LEGAL ISSUES BASED ON PAM 2006 STANDARD FORM OF CONTRACT

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## ABSTRACT

*Non-payment scenario has seriously plagued the construction industry and affects the contractor's cash flow. Contractors nevertheless suspend works if their employers refuse to pay. In Malaysia, this right has been introduced in PAM 2006 Standard Form of Contract for building works. Eventually, PAM 2006 is widely used to manage contractual relationship between contractor and the employer. This paper has been done to explore what are the possible legal issues that may arise when the contractors exercise this right in relation to PAM 2006. The result shows that the employer can challenge contractor's right in suspension of work for several grounds such as the validity of notice to suspend works, validity of interim certificates as grounds for non-payment. Secondly, the employer can challenge contractor's right without proper fulfilment such as mitigation of loss, prevention of delay, and submitting notices. Thirdly, contractor may face legal problems in suspending works downstream if there is lack of back to back provisions in PAM 2006 sub-contracts. This paper will significantly illustrate what are the possible legal problems that the contractors may encounter under PAM 2006 and forms a guideline for the contractors to suspend work cautiously and effectively without having to suffer for legal difficulties.*

**KEYWORDS:** *Non-Payment, Suspension of Work, Legal Issues, PAM 2006 Standard Form of Contract*

## 1.0 INTRODUCTION

Construction industry is vital for the nation's growth, and will only continue to function with the basis that the people are properly paid (Lim, 2005). However, over the years, this industry has been plagued by the non-payment scenario, and directly affecting contractor's cash flow. Basically, the contractor would be left with the option of progressing with the work or choose to terminate the contract. Indeed, termination as the

way to remedy non-payment is expressly stated out in some standard form of contracts, however as a matter of practice, many unpaid contractors are reluctant to go on the route of termination (Lim, 2005).

According to Bernama (2009), encouraged to be one of the avenues in solving problems of non payments by the employer, the Malaysian construction industry had been pushing for the act that provides for *inter alia* the suspension of work since 2004 and yet, there has been little progress until now while the other countries such as UK, New Zealand, Australia, Isle of Man, and Singapore has incorporated this right in their building acts since a very long time ago. However, there is no common law right for contractor to suspend works for non-payment. In Malaysia, it appears that without specific statutory provisions, the contractors have no opportunity to exercise this option, but to rely on express rights stated in contracts. Luckily, this right has been introduced in PAM 2006 Standard Form of Contract for building works. Enshrined in PAM 2006, eventually it gives a new dimension for the contractors rather than terminating the contract and other avenues which put their interest at stake and consumes time and money.

## **2.0 ISSUES UNDERPINNING THE WORK**

Despite of the importance of suspension of work as a remedy against non-payment in Malaysia being promoted by the key players, yet a recent survey study carried out by University Malaya has shown that contractors are less willing to exercise out the right to suspend works and their responds towards this right is unfavorable compared to the other avenues (Mohd Danuri *et. al.*, 2006). Hence, first impression comes to mind is that the right to suspend works enshrined in what we have now in standard form of contracts such as PAM 2006 might posses certain difficulties which impede contractor's interest in exercising this right against non-payment by the employer.

The question here is: "Is there really a problem with using this provision?" Unfortunately there are no study made and no writings can provide this information. Similarly in Malaysia, PAM 2006 had been launched 4 years ago respectively, and yet there is no single case law that illustrates contractors exercising out suspension of work. Despite of the convenience of this right under statutes in UK, Australia, New Zealand, and Isle of Man there is almost no case law which illustrate contractors exercising the

right to suspend works except 1 case law in New Zealand - *Marsden Villas Limited vs Wooding Construction Limited*. In this case, the employer had challenged the contractor's right in suspension of work. The employer had argued that the contractor was not entitled for suspension when he had served the contractor payment schedule, however the court held that the only way to lift the suspension was to pay the full amount to the contractor.

Following the New Zealand case, however in practice there are still various possibilities under which a contractor's action in suspension of work may be challenged by the employer. This can pose a big problem to the contractor when they suspend works. Eventually, there are various possible grounds that the employer may be able do that. However to what extent these problems stated notionally will arise when contractor exercises out his right of suspension based on PAM 2006 remains unanswered unless research and study has been done. There is less information and almost no law cases that can show the contractor has attempted his right in suspension of work against non-payment. Lackluster of this information may cause the contractors to less acknowledged about what are do's and don'ts in exercising out their right in suspending works against non-payment. Eventually there is a need to have a research that can shed a light to the contractors in having a clear awareness of the possible problems when exercising out suspension of work and strengthen their understanding in the mechanism of suspension of work against non-payment based on PAM 2006 Standard Form of Contract.

### **3.0 METHODOLOGY**

This research has been carried out based on a legal research, and unlike empirical research, this study was not done based on statistical study. The primary data for this research are clauses in the construction contracts such as PAM 2006 and stipulates the right of suspension by the contractor against non-payment by the employer. Nevertheless, law cases forms an important source of the primary data which can be searched by using Lexis Nexis Engine. Although there are no direct law cases regarding to contractor exercising the right of suspension of work, however other law cases which relates to issues of payment, certificates, etc will be sought and analyzed as these cases answers and dictate what are the possible problems that may arise when the contractor suspends works.

#### 4.0 POSSIBLE LEGAL ISSUES

Generally, the contractor can suspend works for non-payment stipulated in clause 30.7 PAM 2006. Since there are no direct cases that deal with the proposition, hence the discussion of the issues is by way of indirect cases which are related to the problems that may arise when contractor suspend works. Generally, there are 3 major problems that the contractor may face while suspending works, and will be illustrated below:

##### **Possible Legal Issue 1: Challenges to Contractor’s Right in Suspension of Works by the Employer**

The contractor’s right to exercise suspension of works under PAM 2006 nevertheless is subject to certain fulfillment of certain condition as set out in the clauses. Defaulting employer whose contractor has suspended works under the express provisions may challenge such action on the ground that the suspension of work is invalid or wrongful for a variety reasons. The possible reasons are:

##### **(a) Notice to Suspend Works Has Been Given Unreasonably or Vexatiously**

**Table 1** Cases exemplifying “unreasonable and vexatious”

<b>Cases</b>	<b>Issues/ Significance</b>
J.M Hill and Sons Ltd vs. London Borough of Camden	<b>“Employer claims notice of determination was unreasonable”</b> Court defined “unreasonable” as the act of taking advantage on the employer
John Jarvis vs. Rockdale Housing Association Ltd	<b>“Employer claims notice of determination was vexatious”</b> Court defined “vexatious” as the act of ulterior motive to oppress, harass, or annoy.
Reinwood Ltd v Brown & Sons Ltd	<b>“Employer claims the notice of determination was unreasonable and vexatious”</b> *Court defined “unreasonable” as disproportionately disadvantages the employer, and “vexatious” is termed as ulterior motive or purpose of oppressing, harassing or annoying the employer

According to clause 30.7 in PAM 2006, if the employer do not pay within 14 days after receiving a suspension notice by the contractor, the contractor must further issue a written notice delivered by hand or by registered post to effect his suspension of work and provided that such notice shall not be given **“unreasonably or vexatiously”**. Case law above has defined “unreasonably”, which means contractor’s notice have brought a disproportionately disadvantage to the employer, and may even contend that the notice to be “vexatiously” given, which means the contractor has the ulterior motive or purpose of oppressing, harassing or annoying.

### **(b) Employer Challenges the Validity of Interim Certificates as a Basis for Non Payment**

The biggest fear for the contractor in the line of construction business is that the employer has adequate reason for non-payment. One of the reasons is that the employer challenges the validity of the interim certificate, and refuses to honour the certificate based on the ground of bona fide. The contractor’s right to suspend work nevertheless must in relation to the validly issued certificates. There are several law cases to demonstrate interim certificates can be challenged by the employer for several reasons as such:

**Table 2** Cases exemplifying validity of certificates challenged

<b>Cases</b>	<b>Issues/ Significance</b>
Gunung Bayu Sdn Bhd vs. Syarikat Pembinaan Perlis Sdn Bhd	Interim certificate was not validly issued by registered professional
Ling Heng Toh Co vs. Borneo Development Corporation Sdn Bhd & Lazarus Estates Ltd vs Beasley	Architect/ S.O has been acting impartially, fraudulent in issuing interim certificates
C.M Pilings & Co Ltd vs. Kent Investments Ltd	Interim certificate was fundamentally inaccurate in content and computation

As stipulated in clause 30.1 PAM 2006, after receiving contractor's details and particulars and received payment valuation from the Quantity Surveyor, the architect shall within 21 days issue an interim certificate to the employer with a copy to the contractor, and the employer shall thereafter pay the amount certified to the contractor within period of honouring certificates. As explained in Article 7 in PAM 2006, architect means the person named in article 3 and shall be a professional architect or any other form of practice registered under the Architects Act 1967 and approved by the Boards of Architect. Section 10(1) of Architects act 1967 continues to state that any person who holds the qualification recognized by the Board shall be entitled on application to be registered as a registered Architect. Eventually showed from this case, the employer can claim that the interim certificate was not valid, not issued by the authorized person, and hence lead to arbitration when this circumstances has provide a ground for the employer to challenge the certificates.

Nevertheless, employer can use the ground of "fraud or collusion", by the architect/S.O, challenging the validity of the interim certificate by alleging that the interim certificate was issued due to fraudulent acts by the architect/S.O. Nevertheless, if the employer can succeed in raising the defense showing the issuance of interim certificate was issued in act of fraud by the architect, the interim certificate can be proved to be void and the contractor can have the ground for non-payment.

Finally, the employer can challenge the validity of the interim certificate by raising a bona fide arguable contention with the amount and the accuracy of the certificate issued by his own architect, and claims he is right for not honouring the interim certificate. Eventually, when contractor suspend works due to non-payment by the employer, the employer may raise the bona fide arguments challenging the accuracy of interim certificates as the basis for non-payment.

## **Possible Legal Issue 2: Challenges to Contractor's Entitlements in Suspension of Work**

Nevertheless, when the contractor is able to exercise out his rights in suspension of work due to contractor's default in making payment, the contractor is entitled for claiming loss and expense and extension of time as well. Clause 24.3 (m) PAM 2006 entitles the contractor who

suspends works for non-payment to claim loss and expense arising from such suspension. Similarly, clause 23.8(v) of PAM 2006 entitles the contractor extension of time when he suspends works for non-payment. However, there are several circumstances that may prove difficulties for the contractors to enjoy their entitlement in claiming loss and expense and even claiming extension of time after exercising suspension of work. Those possible circumstances are:

### **(a) Contractor Does Not Mitigate Losses**

**Table 3** Cases exemplifying duty to mitigate loss

<b>Cases</b>	<b>Issues/Significance</b>
Kabatasan Timber Extraction Co vs. Chong Fah Shing	Federal court recognized the general duty of mitigation of loss
Malaysian Rubber Development Corp Bhd vs. Glove Seal Sdn Bhd	Supreme Court eventually held the plaintiff is under a duty to take reasonable steps to mitigate its loss immediately upon the breach by the defendant, buy or sell it in the market if there is an available market or, if there is none, act reasonably to mitigate the loss.

### **(b) Contractor Does Not Use His Best Endeavour/ Reasonable steps to Prevent Delay**

**Table 4** Cases exemplifying duty to prevent delay

<b>Cases</b>	<b>Issues / Significance</b>
IBM UK Ltd vs. Rockware Glass Ltd	IBM has lost his case when the court held IBM had failed to use its best endeavour to obtain planning permission, where IBM has failed to show his prudent, determined and reasonable, acting in his own interest and desiring to achieve the end result.

### **(c) Contractor's Right in Extension of Time and Loss and Expense is deprived For Not Submitting Notices of Claim.**



**Table 5** Cases exemplifying duty to submit notices of claims

Cases	Issues/Significance
Turner Corporation vs. Austotel Pty Limited	Notice delay as condition precedence to an extension of time .The contractor failed to submit the written notice; hence the court held that the contractor lost the right to an extension of time.

From the two cases which emphasized the principle of mitigation, contractor who suspends works nevertheless has to take reasonable steps to mitigate employer’s loss. Indeed, when the contractor exercises the right to suspend works under PAM 2006, the contractor is required to protect and secure works, however claims of loss and expense shall not be made on workmen or machinery for which the contractor can reasonably withdraw, sell, and rent in the market which he can reasonably mitigate employer’s losses by doing so. Since contractor’s claim in loss and expense affects employer’s cash flow, in the employer’s perspective, these claims of loss and expense should not be exaggerated. Hence, with the basis mentioned above, the employer may challenge contractor’s entitlement in claiming loss and expenses by claiming that the contractors are not applying mitigation principle. The criteria of whether the contractor has prevented delay will affect architect’s assessment in granting extension of time. As stipulated in clause 23.5 PAM 2006, when the contractor has submitted sufficient particulars for the architect’s consideration, the architect shall subject to clause 23.5, clause 23.6 ( duty to prevent delay) and 23.8 consider the contractor’s submission and shall either reject the contractor’s application or otherwise.

As stipulated in clause 23.6 PAM 2006, *“the contractor shall constantly use his best endeavour to prevent, or reduce delay in the progress of the works, and to do all that may reasonably be required to the satisfaction of the architect to prevent and reduce delay or further delay in the completion of the Works beyond the completion date”*. From this case, it can be summarized that when a contract requires the contractor to use his best endeavours to prevent delay or reduce delay, he is expected to keep the effect of any matters which would cause delay down to minimum or to eliminate them if possible by using whatever is in their power. Contractor’s entitlement and period of extension of time might not be fully enjoyed if



the contractor was held not using best endeavour to reduce delay, for example stalling employer's effort in making full payment with the intention to prolong the suspension period so that extension of time can be prolonged as well; or not remobilize and resume works within reasonable time after suspension period has lapsed.

Nevertheless, contractor's entitlement in claiming loss and expense when suspending works is always subjected to procedures in contracts. In PAM 2006, clause 24.1(a) states that submission of notice of his intention to claim for loss and expense to the architect shall be a **condition precedent** to any entitlement to loss and expense that the contractor may have under contract and common law. Such notice shall be given in writing with an initial estimate of his claim duly supported with all necessary calculations, and must be given within 28 days from the start of suspension, whichever is earlier. Similarly in clause 23.1(a) PAM 2006 states that submission of notice of his intention to claim for extension of time to the architect shall be a **condition precedent** to any entitlement to extension of time. Such notice shall be given in writing with an initial estimate of his claim duly supported with all particulars of the cause of delay and must be given within 28 days from the start of suspension, whichever is earlier.

### **Possible Legal Issue 3: Problems of Back-to-Back Provisions in Sub Contracts**

Contractor should expect that when he suspends works due to non-payment by the employer in the main contracts, he can temporarily suspend the sub-contractor's works as well, commensurate downstream and tie his subcontractors on a "back-to-back basis" in the sub-contract agreement. Another possible problem that may arise when contractor exercising suspension of work is that this back-to-back basis are not strong in its attempt to incorporate the main-contract terms relating to suspension of work into the sub-contracts.

**Table 6** Cases exemplifying “back-to-back” to basis

Case	Issues/Significance
Chandler Bros Ltd vs Boswell	The sub-contract did not specifically give the main contractor a power of removing sub-contractor, and when the contractor follows the employer’s instruction to remove the sub-contractor, the court of appeal held that the main contractor was guilty of a breach of the sub-contract

Eventually learned from this case, a general stipulation providing that “all the terms of the main contract are hereby incorporated in the subcontract” may somehow not always be appropriate, and not enough.

Back-to-back provisions nevertheless must be clear, direct, and do not incorporate any disambiguates in the sub-contracts. Fundamental issues easy arise between contractors and sub-contractors easily arise because lack of precision as to the actual terms and conditions. Contractors suspending works nevertheless ensure that he has the right to order the sub-contractor to suspend works when he is suspending works.

In PAM Sub-Contract 2006 (Nominated), back-to-back provisions have been incorporated in sub-clause 26.16 (suspension of main Contract Works), which stipulates that: “Where under the Main Contract, the contractor exercises his right to suspend performance of his obligations, the Contractor shall so notify the sub-contractor in writing and may direct the Sub-contractor to suspend performance of the Sub-contract works. The Sub-contractor shall be entitled to an appropriate extension of time under clause 21.0 and loss/or expense under clause 22.0”. This “back-to-back clause” of PAM Sub-Contract 2006 has incorporate well what the main contract of PAM 2006 main contracts stipulate about suspension of work, and eventually when the nominated sub contractor received notification of writing by the contractor to suspend works, he is entitled for loss and expense and extension of time.

Since there is no formal draft and standard form of Domestic Sub Contracts, a quick study on “Model terms of Construction Contract between Contractor and Subcontractor for Subcontract work” published by CIDB Malaysia has been made. However, a clear back-to-back

provision of contractor suspending works is not stipulated in the model contract. So far as concerned, only "termination clause" is clearly stated out in this model subcontract. Suspension of work is not stipulated and incorporated in this model term, nevertheless pose a potential problem for contractors to commensurate suspension of work downstream towards domestic sub-contractors.

## **5.0 SIGNIFICANCE**

This paper has illustrated the possible problems that may arise when the contractor suspends works against non-payment based on PAM 2006. As discussed here, the first major problem that may arise when the contractor suspends works is that his suspension of work is challenged by the employer based on several grounds. From the cases discussed and analyzed here, when the contractor suspends works, the employer can claim that the contractor's notice of suspension of work has been given "unreasonably and vexatiously". Next, employer can always challenge the validity of interim certificate as the ground for non-payment. As suspension of work by the contractor is nevertheless in relation to the validity of interim certificates, employer can argue that the interim certificates is not valid for reason such as not properly issued by registered professional, wrong in computation and amount, and even fraud and issued impartially by architect or S.O.

The second major problem that contractor will face when suspend works is that his entitlement in suspension work such as loss and expense and extension of time is challenged for few reasons, such as failure to apply mitigation principle, failure to use best endeavours or reasonable steps to prevent or reduce delay. Nevertheless, the contractor may even face the problems of losing his entitlement in these claims when he does not submit claims which have been made condition precedent in PAM 2006.

Finally, as suspension of work relates to sub-contractors as well, the contractor may face problems commensurate suspension of work downstream and tie his subcontractor on back-to-back basis. Case law has demonstrated that without clear and incorporation of terms from the main contract to the sub-contract, contractor will face dilemma and disputes are bound to happen. Eventually contractor suspends works under PAM 2006 will have a good flow in suspending nominated sub-contractor's work as

the power to suspend sub contractors has been incorporated in PAM Sub-Contract 2006. In Malaysia however, there is still no standard form of domestic sub contracts, except the “Model terms of Construction Contract between Contractor and Subcontractor for Subcontract work” published by CIDB. However, this model do not expressly provides the power for the contractor to suspend the domestic sub-contractors on a back-to back-basis.

Suspension of work for non-payment has been regarded as a self help-remedy that enables the contractor to take actions against non-payment by the employer. However over the years barely no case law that can demonstrate and provide information about the problems that the contractor may encounter when suspending works, this research has shed a light in exposing what are the possible problems that the contractor may encounter when exercising his right in suspending works against non-payment based on discussions in PAM 2006. With all these findings, eventually this research has reached its objective in finding the possible problems when the contractor suspend works which have taken into account the criteria such as employer to contractor basis, entitlements of suspension of work itself, and contractor-subcontractor basis. These possible problems can indirectly form a guideline for the contractor about the do’s and don’ts in exercising suspension of work based on PAM 2006.

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