

A "Construction Industry Payment And Adjudication Act": Reducing Payment-Default and Increasing Dispute Resolution Efficiency in Construction

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This paper is in two parts. Part I covers various issues relating to payment in the Malaysian construction industry, the proposed 'Construction Industry Payment and Adjudication Act' and some details on construction adjudication as a speedy, economical, contemporaneous, and binding dispute resolution mechanism. Part II is in a question and answer format covering nearly 50 questions that attempts to provide responses to many questions that may remain in various related areas.

PART I

Introduction & Background

Payment Default In The Malaysian Construction Industry

Payment has been said to be the life-blood of the construction industry. Yet the industry knows payment default, specifically delayed and non-payment, remain a major problem. A recent survey done by the Construction Industry Development Board (CIDB) in collaboration with University Malaya (UM) 'merely' formally documents what many in the construction industry already know - there is a chronic problem of delayed and non-payment in the Malaysian construction industry affecting the entire delivery chain. What the survey does do is to provide empirical evidence. It also extends the findings to project estimates of delayed and non-payment amounts based on feedback from a sample of industry players providing information on payment problems between 2000 and early 2006. The projected amounts are staggering. Putting it mildly the

projected estimated figures run into billions of Ringgit.

Master Builders Association Malaysia (MBAM) has also long been lamenting on the problems of delayed and non-payment in the construction industry. And MBAM too has been carrying out surveys on payment issues. The surveys only confirm the harsh reality – payment default is a major problem in the construction industry. Only the extent varies with each survey.

Experience Of Other Countries

One of the moves in the UK construction industry following Sir Michael Latham's 1994 report '*Constructing the Team*' generally known as the Latham Report, was the drafting of the Housing Grants, Construction and Regeneration Act 1996 (UK Act). Part of the Act deals with a scheme for payment and the resolution of construction disputes through a contemporaneous, speedy and economical dispute resolution method called adjudication.

Since then there are now similar Acts in Australia, New Zealand and Singapore. These include:

- Building and Construction Industry Security of Payment Act 1999 amended in 2002 (New South Wales, Australia)
- Building and Construction Industry Security of Payment Act 2002 (Victoria, Australia)
- Construction Contracts Act 2002 (New Zealand)
- Building and Construction Industry Payments Act 2004 (Queensland, Australia)
- Construction Contracts Act 2004 (Western Australia)
- Construction Contracts (Security of Payment) Act 2004 (Northern Territory, Australia)
- Building and Construction Industry Security of Payment Act 2004 (Singapore)

Some of these countries learnt the consequences of payment default the hard ways – slow and sudden

insolvencies, and minor and major insolvencies. Some of these countries scrambled to get statutory provisions after a few major disasters.

Construction Industry Working Group on Payment (WG 10)

Based on our own problems, payment was identified as one of ten priority areas in the Malaysian construction industry during a construction industry roundtable in June 2003. An industry working group (WG 10) led by the Institution of Surveyors Malaysia (ISM) was then formed. Given the industry experience on payment problems and taking heed of experience of other countries, WG 10 then made various recommendations during the construction industry roundtable in June 2004 chaired by the Honorable Minister of Works. One of the recommendations was for the creation of a Malaysian 'Construction Industry Payment and Adjudication Act'.

Following agreement in principle during the meeting, WG 10 moved towards its evolving vision which could be summarized as: 'payment in the construction industry is timely' - where everyone in the construction industry pays the appropriate amounts due in a timely manner. That ties in with the construction industry masterplan vision of making the Malaysian construction industry world class by 2015. These in turn fit in with Malaysia's 2020 vision of becoming a fully developed country.

One cannot have a 'world class construction industry' if even 'mundane' things like payment is not being honoured – whether in a timely manner or at all!

I outline, in this paper, some key recommendations and developments on the plans to make the WG 10 vision a reality including the main recommendation for a Malaysian 'Construction Industry Payment and Adjudication Act'.

Payment And The Construction Industry

The importance of payment in the construction industry

The total contribution to Gross Domestic Product (GDP) by the construction industry is significant. Whilst in Malaysia it is in single digit, some developed countries have the construction industry contributing more than 10% to GDP.

Payment in any industry has generally been an issue of concern. In the construction industry payment is an issue of major concern. This is because:

- (a) Unlike many other industries, the durations of construction projects are relatively long;
- (b) The size of each construction project is relatively large and each progress payment sum involved are often relatively large; and
- (c) Payment terms are usually on credit rather than payment on delivery.

Contrast these with say the medical industry or the tourism industry where the size of each transaction is typically much smaller. The durations of transactions in other industries are also generally much shorter.

Cash Flow

Cash flow in the construction industry is critical because of the relatively long duration of projects. A planned expected revenue flow is usually represented by an S curve. Any deviation due to either project delays or cash flow delays can have a major impact on the project.

Diagram 1 below shows two planned S curves with different contract sums. If a deviation occurs halfway through the project, it becomes increasingly more difficult to recover if the original duration is to be maintained. This is because the graph starts with a gentle slope then moves into a steep slope before tapering off gently. Accelerating to catch up on lost time on an already steep slope is an enormous task.

The Self-Test Question On Payment

The United Kingdom, nearly all states in Australia, New Zealand, and more recently Singapore have all statutorily enacted provisions to address issues on payment in the construction industry and have introduced adjudication as a fast, economical dispute resolution method for the construction industry. Malaysia too must not under-estimate the potential disastrous consequences of persistent payment default across the industry and the economy. At some

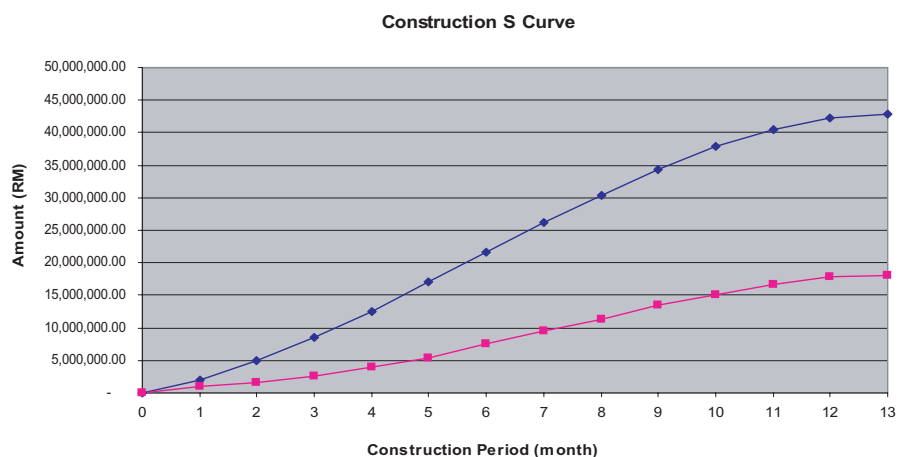


Diagram 1

levels the problems are serious. We cannot also deny that existing contractual arrangements and general legislation has not prevented the problems. The test is in present results – not what results we *could have* achieved.

There is one self-test question that can be used to assess the seriousness of the problem. Ask yourself the following question and answer honestly:

If all the past amounts due were paid to your company today, and from today onwards all amounts due are paid promptly and in a timely manner, where would that put you and your company financially – today, and in the future?

The more significant the impact of your answer on your company's financial situation, the more serious the problem on payment is.

Even without the benefits of the survey results commissioned by the CIDB and UM, that question remains a self-test question for individuals in the industry to realize the seriousness of the problem and to realize the potential benefit of reducing the problem. The seriousness of the problem has already been recognized by leaders in the construction industry. Thus the identification of payment as an issue of major concern and the formation of WG 10. Further recognition of the problem was evident when the recommendations for the proposed Act were rapidly accepted by the industry during the Construction Industry Roundtable in June 2004 chaired by the Honorable Minister of Works.

Following the June 2004 industry roundtable, a further open national conference was held in August 2004 to gather wider feedback from industry. And in order to get the maximum benefit from the experience of other countries around the world, WG 10

recommended an international conference to be held in Kuala Lumpur. This was primarily sponsored by the CIDB and held on 13 & 14 September 2005. The international conference gathered about 18 top authorities from around the world including all the countries that have introduced legislation on payment and construction adjudication. This international conference on payment and adjudication legislation was acclaimed to be the first of its kind in the world. Valuable feedback and comments based on international experience were noted. Since then further wide consultation and briefings have been held in Malaysia including briefings to captains of industry, professional bodies, trade organizations, academic institutions, federal and state government ministries and departments and the Attorney-General's chambers. Following the development of early concept proposals of our model, exchanges of feedback was also held with experts from Singapore, New Zealand and the United Kingdom.

The Malaysian Visions

Malaysia has set its vision to be a fully developed nation by 2020. The construction industry has set its own vision to be *'among the best in the world'* by 2015. As part of the plan, working groups on ten priority areas were set up in June 2003. WG 10 was but only one of ten.

If the Malaysian construction industry is to be *'among the best in the world'*, the working group had to have an equally challenging vision. The vision of the working group on payment is:

Everyone in the construction industry pays all appropriate amounts due in a timely manner.

I now elaborate on the vision of WG 10 and how it can contribute towards

reducing payment default and increasing efficiency in resolving disputes in the construction industry.

'Everyone'

Everyone means *everyone* involved in the delivery chain of construction projects. They include:

- Clients (both public and private sectors),
- Construction consultants involved in construction projects such as architects, engineers and quantity surveyors. (Peculiarly, the New Zealand Act does not cover professional services relating to construction work)
- Main contractors,
- Sub-contractors,
- Sub-sub-contractors,
- Suppliers

'The Construction Industry'

The construction industry includes the building and civil engineering sectors. Whether other sectors such as the oil and gas and shipping sectors should be included is a question of policy to be decided. Other countries do not include the shipping industry and I think rightfully so. However typically the oil and gas sector too has been excluded. If *'because there is no problem on payment in the oil and gas sector'* is the only reason, I do not see why the oil and gas sector should be excluded. Some of the court cases on adjudication in the UK are on *'peripheral'* issues such as whether a contract falls under the definition of a *'construction contract.'* By having an all encompassing definition, disputes on such *'peripheral'* issues can be avoided.

The UK Act has been so successful since it came into force in May 1998 that the process of adjudication is now even being discussed for use in other industries.

'Pay All Appropriate Amounts Due'

'Appropriate amounts due' means someone would have to decide what such amount is. Where standard terms of contracts are used the mechanism would be through the normal existing certification process by an independent contract administrator eg superintending officer or architect contract administrator. Even if the contract administrator is not employed independently but is instead an employee of one of the parties, the law would imply that duty to be discharged fairly. And if payment is still not made following the normal certification process or the amount certified is alleged to be 'unfair', an adjudicator may be called upon to 'adjudicate' on the certificate or other claims.

Where there is no provision for a contract administrator or progress payment at all, such as the thousands of present 'domestic' sub-contracts or 'one-off' small contracts that are entered into on a regular basis, legislation can step in to regularize payment through a default payment mechanism. Again the process of adjudication can step in to ensure it is done independently and fairly.

Following the independent process of adjudication through legislation, there is a much higher possibility of support from the court system in enforcing adjudicators' decisions. This has been the experience in other countries with such legislation.

Parties who have had a fair 'hearing' of their case through an independent adjudicator too are likely to accept the adjudicator's decision and are less likely to seek to open up the same dispute in a protracted, relatively expensive arbitration or litigation. Again that has been the experience in other countries with such legislation.

'Timely Manner'

This is a key point in the WG 10 vision statement. It is important to distinguish:

- (i) the *actual time* or *duration* within which payment must be made; and
- (ii) the *timeliness* of payment.

The *actual time* within which payment must be made is the duration eg. 30 days or 60 days given, within which payment must be made.

Timeliness on the other hand refers to the *punctuality* of payment.

Example. if a contract specifies payment within 30 days, payment must be made within 30 days. If the contract specifies payment within 14 days or 6 months then payment is due within the 14 days or 6 months respectively.

If a contract stipulates payment within 90 days and payment is made in 80 days payment can be said to be *timely*. But in a contract which stipulates payment within 60 days, if payment is made in 80 days, payment is *not timely*.

Both, actual time for payment and timeliness are important. But between the two, consistent timely payment is more important. There are two reasons for this. First, because planned cash flow is critical to a business, particularly in the construction industry. And secondly, because a longer period for payment, known upfront, can be planned and priced for in advance. Indeed if the time for payment is unacceptably long a contractor might even choose not to tender. On the other hand, deviations from an original plan require re-planning, are often unpredictable and can have a knock-on effect on many other activities.

Actual Time or Absolute Time

The actual time or period needed would vary among players in the construction industry. The time period needed can be stated in the contracts - upfront. Circumstances of the paying party can be incorporated eg. internal accounting procedures, audit procedures and even management bureaucracy. The party bidding for the contract can then price accordingly. Example, if the contract states payment is due within 90 days from the date of certification on a particular project compared to a typical 30 day due period, the bidder can plan and price for the long period through extra facilities such as overdraft *knowing well upfront* the longer period for payment due. In some cases the bidder may even opt not to tender if the period is unacceptable.

Timeliness

Failure on timeliness on the other hand has wide ranging implications.

- **Integrity**

A failure to pay within the time stipulated is a breach of promise – a compromise on business ethics. Studies on leadership consistently identify integrity as among the top traits of leaders. A person of integrity does not breach promises. The Malaysian construction industry has set its target to be '*among the best in the world*'. To be among the best means to be a leader in the world.

Studies also suggest the trait of integrity must be present *consistently* if we are to achieve this vision of world leadership. Without consistent integrity, eventually one will fall. '*Situational integrity*' would not do – if we are to be world class leaders. '*Situational integrity*' is where the level of integrity of a person fluctuates depending on the situation faced. Thus a breach on using pirated

software on one computer in the office is sometimes waved away as trivial which doesn't affect the company's 'overall integrity'! Or a company which has tax planned and has *avoided* (which is lawful) some taxes and at the same time *evaded* (which is unlawful) some tax cannot be said to be a company of integrity. One is either pregnant or not pregnant. One cannot be 'partly pregnant' nor have 'situational pregnancy'. In the same way one either has integrity or doesn't. Situational integrity usually means no integrity.

- *Project Delays, Reduced Profitability and Possible Liquidation*

A failure on timely payment also affects programmes which are pre-planned. This affects cash flow which in turn can affect progress of the works and profitability. In bad cases as has happened in other countries such as the United Kingdom, Australia, New Zealand and Singapore, many companies facing unplanned cashflow problems ended up in liquidation. In the UK, between 1989 and 1994, over 35,000 businesses and companies became insolvent with almost half a million jobs lost. That and the Latham Report eventually resulted in the drafting of the UK Act.

In New Zealand, insolvencies specifically in the construction industry since 1998 included names spread throughout the country such as David Brown Construction, Auckland, Voss Construction, Wellington, Replica Homes, Christchurch and several others such as Campbell Construction, Equinox Construction and Hartner Construction. Earlier, major insolvencies included McMillan & Lockwood Ltd and Angus Construction. These were followed by consequential failures of large numbers of subcontractors. These events prompted serious action which eventually resulted in the drafting and enactment of the New Zealand Construction Contracts Act 2002.

Thus, a failure on timely payment can result in project delays, reduced profitability and can even lead to companies going into liquidation. None of these effects should be present at any significant levels if an industry is to be *'among the best in the world'*. Currently it is common for construction projects in Malaysia to be late. Some of the reasons for the delay can be attributed to delayed payment. We have only nine years to go before 2015. Much work needs to be done over the next nine years – if we are to move towards substantially eliminating payment default. Tall order. But not impossible.

'Some men see things as they are and say why. I dream things that never were and say why not.' Robert F Kennedy, paraphrasing George Bernard Shaw.

Many in the construction industry see and often themselves suffer the effects of payment default and keep moaning about the problem – sometimes giving reasons for the problem. What we must do is to envision a dream like *'payment in the construction industry is timely' - where everyone in the construction industry pays the appropriate amounts due in a timely manner*. Thus dreaming of things even if it may appear idealistic and maintain the stand *'why not.'* After all the construction industry masterplan does speak of being *'world class'*.

When I speak to people in the industry about the WG 10 long term vision of 2015, I keep hearing a common lament – *'I hope that is not too late.'* Fresh in their minds are the *'safety collapse'* case of Dr Liew in Sri Hartamas, Kuala Lumpur, and the gory reminder of the Highlands Towers case – a *'quality collapse'*. The Malaysian construction industry could do without a *'financial collapse'* as was the case in many other countries.

I have highlighted these reminders, the re-action in other countries and how we, in Malaysia, should be *'pro-active'* in our actions and avoid any potential

'financial collapse' at various forums including briefings mostly organized by the Construction Industry Development Board (which comes under the purview of the Ministry of Works) to captains of industry, professional bodies, trade organizations, academic institutions, federal and state government ministries and departments and the Attorney-General's chambers. In my capacity as President of the Institution of Surveyors Malaysia, I similarly highlighted these reminders at the 2005 annual dialogue with the Honorable Minister of Trade and Industry and the annual budget dialogue chaired by the Right Honorable Prime Minister in the presence of the Honorable Finance Minister II and all other Ministry representatives. My request was for timely support of the proposed Act. After all the wise learn from *other* people's mistakes.

Addressing The Vision – A Two Pronged Approach

Nine years may seem a long time to achieve the stated vision. But it is not. To achieve this vision, a two pronged approach is recommended:

1. A fundamental change in the mindset towards timely payment. This can partly be achieved through self realization of concepts such as present buzz words like *'good corporate governance'*, or through concepts I have stated earlier in this paper such as realization of *'situational integrity'* or *'partial integrity'* and its analogy of being *'part pregnant'*; and
2. Statutory enactment to give enough bite, particularly in the short to medium term and in cases where there are chronic problems.

This paper covers the second prong rather than the first – although I would recommend the first be also taken up, possibly at other forums.

Although the first is the preferred method in a mature society, to achieve the vision within nine years, the stick method (such as through statutory provisions) is also needed. Here is an analogy. The tax laws in Malaysia have now been amended assuming a more mature society where everyone is responsible enough to self-assess their own taxes and declare and pay *all* taxes due. But the tax department too knows the 'stick' method must complement the 'mature' method. Hence the warning that their officers will conduct random checks!

A Malaysian 'Construction Industry Payment and Adjudication Act'

Support for a Malaysian 'Construction Industry Payment and Adjudication Act' by the construction industry players has been overwhelming. And MBAM has been a consistent major supporter and contributor to the refinement of the conceptual proposals.

The next question to be considered is how our version of a model 'Construction Industry Payment and Adjudication Act' should be. Should we just adopt any one of the models already developed around the world? Or is our situation different such that we cannot accept these models 'lock, stock and barrel'. Should we have something that is better than the current best?

We have in the past adopted the UK JCT 63 building contract lock, stock and nearly all barrels. We renamed it the PAM 69 contract. And despite serious judicial criticism we 'lived with it' for nearly thirty years! The vast majority of Malaysian society, not being a litigious one, did not directly face the consequences of the shortfalls of the contract. But ask the few who did end up in court. They will clearly say reforms to the contract must be made and ought to have been made much earlier. Ignorance is not bliss. Just

because there were few cases on PAM 69 in Malaysia does not mean the contract was 'ok'. It required the efforts of only a few – commissioned by Pertubuhan Akitek Malaysia - to make the transformation to what is now the PAM 98 contract and possibly and hopefully soon the 2006 or 2007 edition.

Few people are all that is needed to initiate the move for the construction industry to achieve its 2015 vision of being 'world class'. Likewise for WG 10 to achieve its vision of:

Everyone in the construction industry pays all appropriate amounts due in a timely manner.

Although only a few people are needed to initiate the change, the masses must support it to make it a success. And ideally there must be consensus. The construction industry has supported it overwhelmingly so far – although certain aspects of security for payment suited to Malaysia is yet to be agreed consensually.

Contents of a Construction Industry Payment and Adjudication Act

Typically the relevant acts around the world cover various common aspects including the following. These are considered in some detail below:

- A scheme for regular payment where there is no provision for a payment mechanism in a construction contract. I repeat – 'where there is no provision for a payment mechanism in a construction contract.'
- Outlawing 'pay-when-paid' and 'pay-if-paid' clauses in construction contracts
- The rights for a party who has not been paid to suspend works
- The provision of a speedy dispute resolution process called

adjudication for disputes relating to a construction contract

- The provision of remedies for the recovery and security of payment under a construction contract

These are some of the major issues that have been debated by the industry at length for inclusion in the proposed Malaysian Act. In addition, statutorily providing the right to interest on late payment has also been suggested.

I now briefly consider some of the areas that may be covered in the proposed Malaysian Act and how they may help towards eliminating payment default:

A scheme for payment where there is no provision for progress payment in a construction contract

This can be an issue in one-off contracts typical on smaller projects and in the large number of sub-contracts and sub-sub-contracts where the main contractor selects his own sub-contractor – generally referred to as 'domestic' sub-contractors. A typical statutory provision would provide for a default mechanism *if* a construction contract does not provide for a payment mechanism.

The intentions in the proposals for the Malaysian Act are clear. The parties to a construction contract are free to agree terms of payment – whether payment in 30 days or even 100 days of certification, milestone payments, a single bullet payment on completion or even payment in kind. Much of the concept of freedom of contract is preserved. The default mechanism for regular payment is only for cases where there is no payment mechanism provided in the contract.

This clearly is a sensible provision and one that will avoid uncertainty on payment provisions.

Outlawing 'pay-when-paid' and 'pay-if-paid' clauses in construction contracts

None of the nominated sub-contracts published in Malaysia including under the PAM 69, PAM 98, PWD 203 series, IEM or CIDB 2000 contracts contain a 'pay-when-paid' or 'pay-if-paid' clause. They all have 'pay-when-certified' clauses. In other words payment must be made by the main contractor upon certification by the certifier whether or not the main contractor is paid in a timely manner as provided under the main contract.

But many contractor-drafted 'domestic' sub-contracts or sub-sub-contracts contain 'pay-when-paid' or 'pay-if-paid' provisions. 'Domestic' sub-contracts are contracts which a contractor enters into with a sub-contractor chosen by the contractor. The only standard terms of 'domestic' sub-contract published in Malaysia – the *'Model Terms of Construction Contract for Subcontract Work'* published in September 2006 does not have a 'pay-when-paid' or 'pay-if-paid' provision.

Pay-when-paid clauses are those clauses which *defer the time when payment is due* from say a main contractor to a sub-contractor until the main contractor has received payment from the client. Pay-if-paid clauses are clauses which attempt to *exclude even the liability for payment* to a sub-contractor until the main contractor is paid.

The effect of such clauses is that sub-contractors may well end up not being paid for reasons beyond their control. Worse still is a situation where a client may set off amounts due to a main contractor due to the main contractor's own fault. The sub-contractor then does not get paid although they may have done their work properly and were not in breach of their contract.

All the similar Acts around the world typically effectively outlaw pay-when-paid and pay-if-paid provisions. They may not be worded such that such provisions are 'banned', but the effects of the wordings are such that such provisions are 'effectively prohibited'. Eg

Section 13 of the NZ Act states that a *'conditional payment provision of a construction contract has no legal effect' and 'is not enforceable in any civil proceedings'*. Similar provisions are found in the UK Act and the New South Wales, Victorian, Queensland, Western Australian, Northern Territory and Singaporean Acts. A limited exception is made in the UK Act allowing pay-when-paid provisions in situations when a client becomes insolvent. The logic behind the UK Act excluding such protection in the event of insolvency is that the main contractor is in a better position to be able to ascertain the financial credentials of the client with whom the contractor contracted.

Although my earlier views were open on whether to outlaw such provisions, on balance, it now appears clear that like in other countries, these provisions must be outlawed for the Act to be effective *as a whole*.

Consider also a client organization that awards a construction contract to a company within its own group and which is then sub-contracted out. A pay-if-paid clause if not outlawed can then be used as an excuse for not paying the sub-contractor (an outside party) who actually does the work.

It may be timely to remind ourselves *'cash flow is the life blood of the construction industry.'*

Whilst pay-when-paid and pay-if-paid provisions in construction contracts are known and are becoming increasingly common, and these have been recommended to be outlawed, there is one other 'conditional payment' provision worthy of attention. Recommendations have also been made in Malaysia for outlawing payments which are conditional upon 'other arrangements' eg conditional upon availability of funds or drawdown of financing facilities. Eg a client organisation providing for payment to a contractor being conditional upon there being say a minimum balance of RM 2 million in the bank or other accounts. I know

that such provisions do exist in industry now.

Payments conditional upon an architect, engineer, superintending officer, or contract administrator's certificate must not however be outlawed. This is because these certifiers are expected to certify fairly irrespective of their employer. In any case the adjudication provisions recommended for the proposed Act will be a check on any unreasonable conduct by the certifier *contemporaneously*.

The rights of a party who has not been paid to suspend works

This is a typical right provided in other statutory provisions around the world dealing with payment and adjudication. The right to suspend work is not provided in common law. See eg. *Canterbury Pipe Lines Ltd v Christchurch Drainage Board [1979] 2 NZLR 347 (CA) and Lubenham Fidelity & Investments Co Ltd v South Pembrokeshire District Council (1986) 33 BLR 39*. Newer standard terms of construction contracts tend to provide an express right to suspend works following non payment. Eg the CIDB Standard Form of Building Contract 2000 and possibly the 2006 or 2007 amendments to the PAM Standard Form of Building Contract 1998. The PAM nominated sub-contract standard terms have however always had a provision for the sub-contractor to suspend works. Strangely, a similar provision was never correspondingly provided in the main contract.

The necessity for such rights to be conferred statutorily arises because not all construction work is undertaken using published standard terms of contract.

Typically the Acts confer an automatic right to extension of time to the contractor who rightfully suspends work following non-payment. This right will of course cease when payment is finally made.

The recommendation to date for the Malaysian Act is for the right to suspend work to be conferred *only following an adjudicator's decision*.

The provision of a speedy dispute resolution process (adjudication) for disputes relating to a construction contract

Traditionally disputes in the construction industry have been resolved through

arbitration – whenever negotiations could not conclude a disagreement which has become a dispute. Theoretically, and the intent of arbitration was for a fast and economical, binding private dispute resolution mechanism. The reality based on experience is rather different. Rarely will you find an arbitration on a construction dispute being completed from the start of a dispute to a final arbitrator's award in under a year. A typical arbitration on

disputes in the construction industry (from referring a dispute to an appointing body through to getting an award from an arbitrator) could take anything from over a year to a few years and sometimes even more than 5 years. Construction disputes in court usually take longer. The table below is an *estimated indicative comparison* of some salient features comparing litigation, arbitration, adjudication and mediation on a typical construction dispute.

DESCRIPTION	LITIGATION	ARBITRATION	STATUTORILY PROVIDED ADJUDICATON	MEDIATION
Basis of resolution of dispute	Rights based; based on facts, evidence and law	Rights based; based on facts, evidence and law	Rights based; based on facts, evidence and law	Interest based; need not be based on facts, evidence or law. Parties may agree anything (that is lawful)
Tribunal cost* (RM)	5 K	50 K – 300 K	10 K – 50 K	2 K – 15 K
Parties' costs – both sides** (RM)	100 K – 600 K	100 K – 500 K	50 K - 100 K	10 K – 20 K
Duration***	2 - 7 years	1 - 5 years	4 - 8 weeks	1 - 14 days
Rights to the process and pre-conditions	Usually right to litigation precluded if there is an arbitration clause in the contract, but may be used to challenge an arbitrator's award although only on very limited grounds	May only resort to arbitration if there is a written arbitration agreement in the contract or if agreed by the parties at any time	With an enabling Act, adjudication would usually be permitted at any time	Mediation can always be used by the parties at any time
Timing	If there is no arbitration clause, anytime. If there is an arbitration clause, only if an arbitrator's award is being challenged which may be done only on very limited grounds	Usually in construction contracts arbitration clauses provide that arbitrations on most disputes may only start after completion or termination	Anytime	Anytime
Extent to which it may be binding and appealed	Binding, but may be appealed to a higher court	Binding, but the arbitrator's award may be challenged in court although in very limited circumstances	Binding but the same dispute may be reopened in arbitration/litigation	Not binding at any time during the process, except when settlement agreement is reached
Relationship between disputing parties	Usually confrontational	Often quite confrontational	May be a little confrontational	Usually amicable

*Tribunal cost means the costs associated with the sitting tribunal eg court fees, arbitrator's, adjudicator's or mediator's fees and the cost of venue, if any. The amounts shown are only an *estimated indicative range*.

**Parties' cost means costs (*again an estimated indicative range*) that the parties may incur eg. costs of employing lawyers, claims consultants or other experts. But it excludes other internal costs eg. costs associated with the parties' time spent in preparing for the case, time spent at hearings or costs involved in preparing documentation or travel costs.

***Duration: This is an indication of the *estimated indicative time* usually required for a typical construction dispute from the start of the process eg one party writing to the other stating there is a dispute and suggesting it be resolved in an arbitration or adjudication or through mediation through to a judgment, award, decision or settlement agreement.

I have always held the view that various dispute resolution methods must co-exist to complement each other to suit the nature of dispute and the circumstances of each case. But it becomes increasingly important for construction disputes to be settled:

- Speedily;
- Economically;
- In a binding manner;
- Contemporaneously ie when it happens as opposed to years later; and
- Wherever possible for good relationship to be maintained.

Based on the above considerations, mediation and adjudication merit serious attention as methods of resolving construction disputes –

complemented with the opportunity for eventual 'fine justice' in an arbitration, if the parties still need it.



Like in arbitration, in adjudication an independent adjudicator who is appointed steps in and makes a binding decision based on the evidence, facts and the law. The decision binds the parties to the contract immediately upon getting the decision from the adjudicator but unlike the 'finality' of an arbitrator's award the same dispute referred to in adjudication may be opened up again in an arbitration following the provisions in the contract. In construction contracts, for most disputes that typically means following completion or termination. The UK experience shows though that the vast majority of disputes referred to adjudications are not subsequently opened up in arbitration.

Unlike arbitration, the adjudication processes provided statutorily around the world are time limited. The duration is typically statutorily set at 14 days, 20 working or business days, 30 working or business days, 28 days or 42 days. Only if the parties agree, these durations may be extended. Rough justice – maybe, given the short period for the dispute to

be resolved - but it can, and often is resolved *contemporaneously* (meaning when the dispute occurs). Unlike a typical arbitration which can usually only start after completion of works or after termination. And which often results in delayed justice – which some say is justice denied.

In the UK more than 15,000 adjudications have been held since 1998. Over the corresponding period, the number of arbitrations has dropped significantly. So has the number of cases in the Technology and Construction Court (TCC) which handles construction cases. I would not state that the sole reason for the decline in arbitrations or the cases in the TCC are solely because disputes are increasingly being resolved through adjudication or possibly mediation. But what I would say is there is at least anecdotal evidence that, as a minimum, the introduction of adjudication could be partly the reason. If so, isn't that bad news for the 'traditional dispute resolution industry'?

All true professionals know that an essential trait of a professional (and the basis upon which professionals get the authority to act – sometimes statutorily and often to the exclusion of the public at large) is altruism – putting client's and society's interest before self interest. You decide whether the potential effect of introducing adjudication in the construction industry would be in the best interest of society and the economy as a whole.

So far the number of cases in court relating to adjudication that I am aware of are 256 in the UK, 110 in Australia most of which (93) are in New South Wales and 3 in New Zealand. I am aware of one in Malaysia. One party alleged I was properly appointed as an 'adjudicator' as defined in their contract. The other party challenged

my jurisdiction and the appointing body's right to appoint me. Thankfully, it was settled before it proceeded to hearing!

The number of cases might sound like many, but compared to over 15,000 adjudications done to date 369 cases around the world is considered very few. Further, and very importantly, many of the cases were dealing with tangential issues such as jurisdiction of the adjudicator (including the one in Malaysia) and not just on issues relating to the dispute itself. Indeed even after 8 years and over 15,000 adjudications, two of the most recent cases in the UK *Redworth Construction Limited v Brookdale Healthcare Limited* [2006] EWHC 1994, 31 July 2006 and *Harlow & Milner Ltd v Mrs Linda Teasdale* [2006] EWHC 1708, 7 July 2006 both had jurisdiction as a key issue.

The provision of remedies for the recovery of payments under a construction contract

In order to give 'teeth' to the statutory provisions, there must be provisions for remedies for the recovery of payment following a decision or determination of an adjudicator. These are provided in various ways depending on the jurisdiction. In the UK it is provided through enforcing the adjudicator's decision under s 42 of the Arbitration Act 1996. Under the NSW and Victorian Acts, apart from a right to suspend works, it is recovered as a debt. The NSW Act has a procedure to obtain an 'adjudication certificate' which can then be filed 'as a judgment for debt in any court of competent jurisdiction.' Similarly the NZ Act provides for the right to suspend works, to recover the adjudicator's determination as a debt in court and to enter the adjudicator's determination as a judgment in the District Court.

On security for payment, unlike most other countries, the Malaysian scenario

is somewhat different. Malaysia operates substantially on a sell-on-plan scheme. That means purchasers and end financiers would be involved early on in the development. Any attempt to provide security for payment to a contractor, subcontractor or supplier through a lien or charging order scheme might not be in the best public interest and of many of the parties – particularly the purchasers.

According to Sr Lim Chong Fong, a practicing construction lawyer with a background in quantity surveying and who has done much research into this aspect of the proposal for the Act, provisions through a mandatory trust fund too have their shortfalls in Malaysia because tracking of funds movement would remain a problem given the various existing laws in Malaysia. That leaves a third way to obtain security for payment in the construction industry - a system of payment bonds, Sr Lim Chong Fong suggests is the best way to have some security for payment.

So far, providing a mandated system of payment bonds has not had consensus within the construction industry. It is also evident that having a comprehensive scheme of bonds all the way from the client to main contractor to subcontractors to sub subcontractors and suppliers is likely to result in reciprocal insistence of having performance bonds or performance security deposits or retentions sums or a combination of some of these security for performance all the way down the chain of contracts. It was generally felt that then, the increase in costs due to banking charges involved in providing a plethora of payment and performance bonds would not be commensurate with the benefit of security of payment through a statutorily mandated bond system within Malaysia.

At the time of my writing this, the recommendations by the steering

committee on the proposed 'Construction Industry Payment and Adjudication' are for a payment bond to be mandated, but only at head contract level. This was seen as a compromise to avoid excessive cost increase.

There have also been other 'creative' suggestions eg. by REHDA on the possibility of creating a 'contractor's project account'. But this has yet to be explored in detail.

Other Payments

I have one last point on payment to be made. I have simply called it 'other payments'. I wish to re-visit my points on integrity and 'situational integrity'. As I wrote earlier, one is either a person of integrity or not.

If we expect *everyone* to pay the full sums due in a timely manner, we should also pay those who we owe all amounts due in a timely manner. Ideally, upon the due date - whether demanded or not. They include the newspaper man, milkman (if they still exist) IWK, TNB, TM, government service tax and other taxes. And for professionals it includes paying all professional subscriptions within the deadlines – even if one has shifted houses and addresses have not been updated!

Physical infrastructure is but only a part of a *fully* developed nation. In the long run personal integrity must be *all-encompassing* if we are to achieve the vision of:

- (i) Everyone in the construction industry paying all appropriate amounts due in a timely manner; and
- (ii) Making the Malaysian construction industry world class by 2015; and
- (iii) Malaysia becoming a *fully* developed nation by 2020.

PART II - Questions and Answers

This second part is a continuation of the first and is structured in a question and answer format. It attempts to provide responses to many questions that may remain in various related area. They include questions that may remain an area of concern to some.

They are not necessarily frequently asked questions or 'FAQ's. Many of these questions were asked in some of the forums held so far between June 2003 and October 2006 – initially during presentations on the WG 10 recommendations and subsequently on the briefings on the proposed 'Construction Industry Payment and Adjudication Act' to the captains of industry, professional bodies, trade organizations, academic institutions, government ministries and departments (federal and state) and at open construction industry public forums. And some of these questions came from various meetings and discussions I have had either in groups or on a one-to-one basis.

It might appear as many questions. But most of them have been deliberated widely at industry or steering committee level and appropriate recommendations made.

The questions are in no particular order and are not meant to be exhaustive.

Q: So far the Malaysian construction industry has been 'quite okay' and surviving. Why should there now be statutory intervention through the proposed Construction Industry Payment and Adjudication Act?

Q: Aren't other existing Acts in Malaysia adequate to address any problems that might exist in the construction industry?

Q: Will the proposed Act curb the concept of 'freedom of contract'?

Q: The New Zealand Act is known as the Construction Contracts Act 2002. The Western Australian Act is similarly called Construction Contracts Act 2004. If Malaysia were to follow these, does this mean there will be one standard form of construction contract to be mandated for use in the construction industry?

Q: Why is our Act proposed to be called 'Construction Industry Payment and Adjudication Act' whereas all the other countries have different names like 'Housing Grants Construction and Regeneration Act, Construction Contracts Act and quite commonly Building and Construction Industry Security of Payment Act? Is it because our proposed Act is significantly different from the others?

Q: With the proposals at present, can parties to a construction contract agree for payment to be in kind? Example: land swap, payment in the form of completed apartments or even barter trade between say palm oil and construction work?

Q: Would the Act 'look after' the 'poor' sub-sub-works-contractor who actually does the work but is not paid and who might not be the best in understanding complex pieces of legislation?

Q: How would the introduction of adjudication affect the rights to other existing dispute resolution mechanisms like arbitration, going to court or mediation?

Q: The New South Wales model appears to enable only the party who has a right to be paid to refer a dispute to adjudication, but not the other way round. It appears to be a one-way protection. But in industry, there are also cases of poor workmanship or breaches by those who do the work. Is it not unfair if disputes can only be referred one way and not the other?

Q: Can a party refuse to participate in an adjudication?

Q: What would happen if one of the parties to an adjudication refuses to participate in an adjudication?

Q: Can both parties or the adjudicator refuse to continue with an adjudication after having started it?

Q: Who pays for the adjudicator's fees and the cost of hiring venues for meetings etc?

Q: Can and should an adjudicator be named in advance in a construction contract?

- Q: What can a party do if the party feels the adjudicator has made a wrong decision?
- Q: Adjudication has been said to be 'quick and cheap'. The same thing was said of arbitration years ago. What is the likelihood of adjudication becoming not so quick and not so cheap like arbitration?
- Q: What is the likely cost of a typical adjudication? Are there statistics from other countries which have similar Acts?
- Q: If payment bond is to be the 'security for payment', how would that affect other related performance 'counter security' measures like performance bond and retention sums?
- Q: 'On-demand' bonds (often without even any need for proof of default) are common in Malaysia. If payment bonds are going to be mandated, how would it be structured to avoid unwarranted calls on bonds to avoid chaos in cross calling of bonds in the industry?
- Q: What would a party do after getting an adjudicator's decision? How would enforcement be made?
- Q: Some tribunals like arbitration and even some courts have a tribunal of three. Has consideration been given for an adjudication tribunal of three?
- Q: How would an adjudicator's decision have a bearing on the contract administration of an ongoing project?
- Q: Isn't arbitration adequate as a binding dispute resolution mechanism in the construction industry?
- Q: Can direct payment be legally made from a principal (say a client) to a subcontractor without the consent of the main contractor?
- Q: How would 'fairness' be maintained if the claimant has spent months preparing the case and the process of adjudication is to be resolved in a matter of days or weeks at the most. How would the respondent have enough time to respond adequately?
- Q: Given the new Malaysian Arbitration Act 2005, would the proposed Construction Industry Payment and Adjudication Act be redundant?
- Q: Would the proposed Act mean that there will only be one 'payment scheme' in the construction industry?
- Q: Would introducing a quick, cheap, and contemporaneous dispute resolution mechanism like adjudication lead to a proliferation of 'claims consultants'?
- Q: Would introducing a quick, cheap, and contemporaneous dispute resolution mechanism like adjudication lead to a higher number of disputes?
- Q: Would it also lead to more frivolous and unwarranted claims being put forward through adjudication?
- Q: What happens when frivolous or unwarranted claims are put forward in an adjudication?
- Q: What is the difference between a contractually agreed adjudication and statutorily enabled adjudication?
- Q: Who can be adjudicators?
- Q: What would the qualifications of the adjudicators be?
- Q: What training schemes are adjudicators likely to be put through?
- Q: Would adjudicators be accredited by various bodies or a single body?
- Q: Some in industry have lamented on the quality of arbitrators in the country. Are adjudicators too likely to fall into a similar situation?
- Q: Can an adjudicator be sued if the decision made is believed to be wrong or is obviously wrong?
- Q: Can the nominating body be sued for nominating an incompetent adjudicator?
- Q: Can parties agree on an adjudicator or will adjudicators only be nominated by a nominating body?
- Q: Can parties agree on an adjudicator who may not be an accredited adjudicator?

- Q: There are many different sets of rules for arbitration used in Malaysia now. Would there also be multiple sets of rules for adjudication or only one common set?
- Q: Can an adjudicator's decision be appealed either by another adjudicator or by an arbitrator or in the courts?
- Q: Can a dispute that has been adjudicated be referred to another adjudicator or arbitrator or the courts?
- Q: The Singapore model has an immediate 'appeal' system. What would the purpose of an appeal be if the whole idea of adjudication was for a 'quick, speedy, contemporaneous,' even if a bit rough justice, binding decision?
- Q: What happens if an adjudicator is bribed?
- Q: Why has New Zealand excluded professional services from the scope of the Act?
- Q: Some of the Acts cover only written contracts, others also include oral contracts. What would be the advantages and disadvantage of each scheme?
- Q: Some of the Acts cover only issues on payment, whilst other Acts cover all other construction disputes. What would be most beneficial to the Malaysian construction industry?
- Q: The New South Wales Act in Australia outlaws 'legal representation'. Why should this be so? What are the views of industry in Malaysia?
- Q: Would projects funded by the government be bound by the Act? Should they be bound by the Act?
- Q: Would giving an unpaid party the right to suspend work lead to disruption to the work on a project?
- Q: Why can't the concept of lien be introduced in Malaysia as security for the benefit of an unpaid party?
- Q: What is so difficult about introducing a scheme of statutory trust funds in Malaysia as security for payment?
- Q: Aren't 10 working or business days, 14 days, 28 days or even 42 or 60 days too short to resolve complex construction disputes?
- Q: What happens on the day immediately after the deadline expires and the adjudicator has not given his decision?
- Q: What happens if the dispute is on defective work or variation work to several hundred apartment units in several blocks of buildings? How would an adjudicator even have time to inspect or make decisions on all of them?
- Q: If a dispute involves a complex web of issues involving construction law, payment, variations, engineering quality issues and calling of a performance bond, would one 'expert' adjudicator be able to handle all the issues and should only one 'expert' do so?
- Q: There has been talk and recommendations for a 'construction court' in Malaysia like the Technology and Construction Court in the United Kingdom. What is it and in what way would it benefit the construction industry?
- Q: What does the CIDB-UM survey find? Is payment on Government funded projects also a problem area? If so, is it at head contract level or all levels or primarily sub and sub-sub levels?
- Q: Given the current instructions and moves by government to pay contractors promptly, would it be necessary to include Government funded projects in the proposed Act? Would payment still be an issue on Government funded projects if the Government pays promptly?
- And finally the 'bottom-line' and 'million-Ringgit' questions:
- Q: With the proposed Act, will payment-default no longer be an issue in the construction industry?
- Q: With the proposed Act, will construction disputes be resolved much quickly and more economically than at present? If so, how much cheaper or quicker is it likely to be?
- Q: Will the proposed Act help the construction industry become more effective and efficient, helping to realize the Malaysia construction masterplan vision of becoming 'world-class'?