

A REPUDIATORY BREACH IN THE CONSTRUCTION INDUSTRY –  
NON-PAYMENT

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To my beloved dad, mom, Kah Wei, Yong Sin and Jih Kui

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## ABSTRACT

Many complaints have been voiced about non-payments and it is causing severe cash flow problems to contractors. The reaction of many contractors when faced with non-payment is to consider stopping work on site. Whilst this is understandable in many instances, it may amount to a repudiatory breach by the contractor. The contractors are only entitled to terminate the contract when non-payment is a repudiation of contract. But is the act of non-payment goes to the root of the contract? Whether failure to pay amounts to repudiation will depend on the circumstances of the case. Therefore, this study is to identify circumstances where non-payment by an employer constitutes a repudiatory breach of contract. Findings of this study will assist the contractor to understand his position before he takes action when the employer fails to make payment. The approach adopted in this research is case law based; only cases specifically centered on issue of non-payment will be discussed in this study. The selection of sample court cases involved a depth study rather than a random sample. A total number of 11 cases were studied, where 7 of them were involving construction contracts and 4 were contracts of sales of goods. It is found that there are 2 circumstances in which non-payment constitutes to repudiatory breach and 9 circumstances in which non-payment does not amount to repudiation of the contract. As a conclusion, the result of the analysis seems to suggest that, in most of the circumstances, non-payment is not a repudiatory breach of contract by the employer. The contractors are not advised to stop work at the site when the employer refused to make payments, or he himself would be guilty of a breach of contract in failing to maintain regular and diligent progress. But, an employer may be held to be in repudiatory breach of contract in failing to make payment if his action shows an intention no longer to be bound by the contract and his default goes to the root of the contract.

## ABSTRAK

Terdapat banyak kontraktor yang tidak dibayar dan mereka menghadapi masalah kewangan yang serius. Apabila kontraktor tidak dibayar, mereka akan memikir untuk meninggalkan kerja di tapak pembinaan. Walaupun ini dapat difahami, ia mungkin merupakan pecah kontrak oleh kontraktor. Kontraktor hanya boleh menamatkan kontrak apabila tindakan tidak bayar merupakan pecah kontrak oleh majikan. Adakah tindakan tidak bayar merupakan repudiasi? Sama ada tindakan tidak bayar merupakan repudiasi adalah bergantung kepada keadaan. Maka, kajian ini adalah untuk mengenalpasti keadaan di mana tindakan tidak bayar merupakan repudiasi pihak majikan. Hasil kajian akan membantu kontraktor memahami haknya sebelum ia mengambil tindakan apabila majikan tidak membayar. Pendekatan yang diguna dalam kajian ini adalah berdasarkan kes mahkamah, hanya kes yang berpusat pada isu tidak bayar akan dibincang dalam kajian ini. Pemilihan kes adalah secara mendalam, bukannya secara rawak. Sebanyak 11 kes dikaji, di mana 7 melibatkan kontrak pembinaan dan 4 melibatkan kontrak jual beli. Didapati, hanya 2 daripada 11 kes menunjukkan keadaan di mana tidak bayar merupakan repudiasi majikan, dan 9 menunjukkan keadaan di mana tidak bayar tidak merupakan repudiasi majikan. Sebagai kesimpulan, hasil kajian mencadangkan tidak bayar tidak merupakan repudiasi oleh majikan dalam kebanyakan keadaan. Kontraktor adalah tidak dicadangkan untuk meninggalkan kerja di tapak pembinaan apabila majikan tidak bayar, supaya dia tidak didakwa pecah kontrak atas alasan gagal untuk melaksanakan kerja dengan tekun. Tetapi, seseorang majikan akan didakwa repudiasi kerana gagal membayar jika tindakannya menunjukkan dia tidak ingin diikat oleh kontrak, dan tindakannya memecah asas kontrak.

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**LIST OF ABBREVIATIONS**

AC	Law Reports Appeal Case
All ER	All England Law Reports
ALJ	Australian Law Journal
ALR	Australian Law Reports
ALJR	Australian Law Journal Reports
App Cas	Appeal Cases
B	Beavan
B & S	Best and Smith's Reports
Build LR	Building Law Reports
CA	Court of Appeal
CB	Common Bench Reports
Ch	Chancery
Ch App	Chancery Appeal
Ch D	The Law Reports, Chancery Division
CIDB	Construction Industry Development Board
CLD	Construction Law Digest
DC	Divisional Court, England
Const LJ	Construction Law Journal
Const LR	Construction Law Reports
CP	Law Reports, Common Pleas
CPD	Law Reports, Common Pleas Division
DLR	Dominion Law Reports
Exch	Exchequer Reports
Eq	Equity Case
EWHC	High Court of England and Wales Decisions

FC	Federal Court
F & F	Foster & Finlayson's Reports
H & N	Hurlstone & Norman's Exchequer Reports
HL	House of Lords
HKC	Hong Kong Cases
HKLR	Hong Kong Law Reports
IR	Irish Reports
JKR	Jabatan Kerja Raya
KB	King Bench
LGR	Local Government Reports
LJKB (QB)	Law Journal Reports, King's (Queen's) Bench
Lloyd's Rep	Lloyd's List Reports
LR	Law Reports
LT	Law Times Reports
JP	Justice of the Peace / Justice of the Peace Reports
MLJ	Malayan Law Journal
NZLR	New Zealand Law Reports
PAM	Pertubuhan Arkitek Malaysia
PWD	Public Work Department
PD	Probate, Divorce and Admiralty Division of High Court
QB	Queen Bench
TCC	Technology and Construction Court
SLR	Singapore Law Reports
WLR	Weekly Law Reports
WR	Weekly Reports

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## CHAPTER 1

### INTRODUCTION

#### 1.1 Background Studies

The practice of efficient and timely payment in construction projects is a major factor leading to a project's success. Payment has been referred to as the lifeblood of the construction industry due to latter's inherent nature that takes relatively long durations and large amounts of money to complete.<sup>1</sup> The primary obligation upon the employer is to give the contractor the sum of money which forms the consideration for the contract.<sup>2</sup> Furthermore, the contractor has a right to be paid on time.<sup>3</sup> The contractor's right to payment depends upon the wording of the contract. Within the limits of legality parties can make what arrangements they please.<sup>4</sup>

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<sup>1</sup> Construction Industry Development Board, "A Report of a Questionnaire Survey on Late and Non-Payment Issues in the Malaysian Construction Industry." (Kuala Lumpur: CIDB, 2006), p.i.

<sup>2</sup> John Murdoch and Will Hughes, "Construction Contracts: Law and Management." Third Edition. (London: Spon Press, 2000), p.197.

<sup>3</sup> Sundra Rajoo, "The Malaysian Standard Form of Building Contract (The PAM 1998 Form)." Second Edition. (Kuala Lumpur: Malayan Law Journal, 1999), p.295.

<sup>4</sup> Stephen Furst and Vivian Ramsey, "Keating on Building Contracts." Fifth Edition. (London: Sweet & Maxwell, 1991), p.69.

In the construction industry contractors and subcontractors have become accustomed to regular monthly payments. It is this facility which has enabled many businesses to commence with a low capital base. Monthly payment does not result from a basic legal entitlement. The opposite is the case in that, at common law, payment is due following completion of the work. The entitlement to monthly payment comes about from the express provisions in the contract.<sup>5</sup> One of the main purposes of this is to reduce the need for the contractor to fund the development of the project. This is because the total value of each contract forms a large proportion of a contractor's annual turnover. Payment by instalments should eliminate the need for the contractor to borrow money pending final payment.<sup>6</sup> The amount of money due in each instalment is recorded by the contract administrator in an 'interim certificate'. The issue of such a certificate by the contract administrator imposes upon the employer a strict obligation to make payment.<sup>7</sup>

In the local scene, many complaints have been voiced about the events of late and non-payments but the information has been mainly in the form of hearsays. A research conducted by the Master Builders Association of Malaysia (MBAM) has demonstrated that the issue of late and non-payment has persisted in the Malaysian construction industry for quite some time now, but have yet to be fully resolved.<sup>8</sup> According to the Works Minister Datuk Seri S. Samy Vellu<sup>9</sup>:

*“More than 18,000 contractors and sub-contractors were either paid late or have yet to receive payment for completed work totaling RM23.7billion since 2000. This is a very huge sum, about 14% of the allocation for development projects under the 9th Malaysia Plan. The Construction Industry Development Board (CIDB) had carried out a*

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<sup>5</sup> Rodney Martin, “52 Contractual Issues Relevant to Malaysia and Their Resolution.” (Kuala Lumpur: James R Knowles Sdn Bhd, 2005), p.19.

<sup>6</sup> *Supra* note 2.

<sup>7</sup> *Supra* note 2.

<sup>8</sup> *Supra* note 1.

<sup>9</sup> The Star, “18,000 Contractors and Sub-Contractors Paid Late.” (Kuala Lumpur: The Star, 22 August 2006).

*six-month survey on 330 contractors, in which 273 cases of payment problems involving RM877.8mil were reported.”*

This shows that Malaysian construction industry now is prone to late and non-payment culture. Such a problem is felt not only in a fast developing economy, as in the case of Malaysia, but also in developed countries, such as the United Kingdom and Singapore. Late and/or non-payment will cause severe cash flow problems especially to contractors, and this would have a devastating knock-on effect down the contractual payment chain.<sup>10</sup>

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. 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! Malaysia too must not under-estimate the potential disastrous consequences of persistent payment default across the industry and the economy.<sup>11</sup>

## **1.2 Problem Statement**

There is a chronic problem of delayed and non-payment in the Malaysian construction industry affecting the entire delivery chain.<sup>12</sup> Contractors faced with an employer who simply does not pay are in serious difficulties. This can be a very

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<sup>10</sup> *Supra* note 1.

<sup>11</sup> Noushad Ali Naseem Ameer Ali, “A “Construction Industry Payment and Adjudication Act”: Reducing Payment-Default and Increasing Dispute Resolution Efficiency in Construction.” (Kuala Lumpur: Master Builder, 2006), p.1.

<sup>12</sup> *Ibid.*

serious matter for the contractor who may not be able to fund continuation of the project in the face of the employer's breach.<sup>13</sup>

The reaction of many contractors when faced with non-payment is to consider stopping work on site.<sup>14</sup> Some contractors who were complaining of late payment retaliated by withdrawing their labour and most of their plant from the site and thus slowed down progress considerably.<sup>15</sup> Whilst this is understandable in many instances such action could prove fatal.<sup>16</sup> A contractor who suspended work on the ground of not having been paid would be guilty of a breach of contract in failing to maintain regular and diligent progress.<sup>17</sup> The contractor has no right at common law to stop work just because he has not been paid what he considers to be the correct amount.<sup>18</sup>

Whether or not such a right exists is generally a complex matter and contractors are well advised to be extremely cautious and to examine all the potential pitfalls. A contractor may himself be in breach if the correct procedures as may be stipulated in the contract are not followed when attempting suspension / termination.<sup>19</sup> It sometimes happens that one contracting party ('A') is in breach of contract and the other party ('B') treats this as a repudiatory breach, but it is later held that A's breach was not sufficiently serious to justify this. The question which then arises is whether this mistake means that B, who clearly intended no longer to be bound by the contract, is now guilty of a repudiatory breach, so that A is entitled to terminate the contract!<sup>20</sup> But, can the employer gain profit by his own wrong? The

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<sup>13</sup> David Chappell and Vincent Powell-Smith, "The JCT Design and Build Contract." Second Edition. (London: Blackwell, 1999), p.154.

<sup>14</sup> Lim Chong Fong, "The Malaysian PWD Form of Construction Contract." (Kuala Lumpur: Sweet & Maxwell Asia, 2004), p.108.

<sup>15</sup> *Supra* note 2, p.328.

<sup>16</sup> *Supra* note 5.

<sup>17</sup> *Supra* note 2, p.328.

<sup>18</sup> *Lubenham Fidelities & Investment Co. v. South Pembrokeshire District Council and Wigley Fox Partnership* (1986) 33 BLR 39 (CA).

<sup>19</sup> *Supra* note 14.

<sup>20</sup> *Supra* note 2, p.323.

employer cannot rely upon its own breach to justify a contention that the contractor was itself in repudiatory breach.<sup>21</sup>

At common law, one contracting party (A) had no right to suspend performance of contractual obligations on a temporary basis, on the ground that the other party (B) was in breach of contract.<sup>22</sup> Unless B's breach was sufficiently serious to justify A in terminating the contractor altogether, A's only remedy was to claim damages, in the meantime continuing with the contract. The absolute refusal to carry out the work or abandonment of the work before it is practically completed without any lawful excuse is a repudiation by the contractor.<sup>23</sup> Abandonment of the work or refusal to carry on is plainly a breach which goes to the root of the contract.<sup>24</sup>

Therefore, the absolute refusal to carry out the work is a repudiation by the contractor. The issue arises then is, is the contractor still liable for repudiation if the employer failed to make payment at the first place? Clearly, the employer is in breach of contract when they refuse to make payment, but is the act of non-payment goes to the root of the contract?

An employer's obligation to pay the contractor is determined by the payment arrangement envisaged in the terms of the underlying contract.<sup>25</sup> This cannot be a repudiation if there is no contractual duty to pay them. Where there is such a duty it is a question in each case whether failure to pay is a repudiation.<sup>26</sup>

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<sup>21</sup> *C J Elvin Building Services Ltd v. Noble and Another* [2003] EWHC 837 (TCC).

<sup>22</sup> *Channel Tunnel Group Ltd v. Balfour Beatty Construction Ltd* [1992] 2 All ER 609.

<sup>23</sup> *Supra* note 3, p.251.

<sup>24</sup> *Mersey Steel & Iron Co Ltd v. Naylor* (1884) 9 App Cas 434; *Marshall v. Mackintosh* (1898) 78 LT 750; *Hoening v. Issacs* [1952] 2 All ER 176 (CA).

<sup>25</sup> Chow Kok Fong, "Law and Practice of Construction Contracts." (Singapore: Sweet & Maxwell Asia, 2004), p.335.

<sup>26</sup> *Supra* note 4.

Generally, there is no common law right for any party to treat a contract as repudiated simply because the other party is in breach of his obligation to pay.<sup>27</sup> Failure to pay one instalment out of many due under the terms of the contract is not ordinarily sufficient to amount to a repudiation.<sup>28</sup> In addition, a simple delay of a few days in payment, even if persistently repeated, would probably not amount to repudiation.<sup>29</sup>

Under common law, it is probably insufficient to sustain an allegation that the employer has repudiated a contract, unless he has fallen behind in honouring a series of progress payment over a period of time.<sup>30</sup> However, persistent delay in payment can no doubt amount to repudiation, if sufficiently serious.<sup>31</sup> So a clear indication of refusal or inability to pay future instalments will be a repudiation, as also a repeated failure to pay on time in response to warnings, if raising the inference of an intention to pay late habitually so as to derive financial advantage, it is submitted.<sup>32</sup>

What does “repudiation” actually mean? The word “repudiation” is ambiguous and has several meanings, but it is the most convenient term to describe circumstances where “one party so acts or so express himself as to show that he does not mean to accept the obligations of a contract any further. To amount to repudiation a breach must go to the root of the contract. Repudiation is a drastic conclusion which should only be held to arise in clear cases of a refusal, in a matter going to the root of the contract, to perform contractual obligations. Repudiation by one party standing alone does not terminate the contract. It takes two to end it, by repudiation on the one side, and acceptance of the repudiation on the other.<sup>33</sup>

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<sup>27</sup> *Supra* note 13, p.268.

<sup>28</sup> *Supra* note 4.

<sup>29</sup> *Supra* note 3, p. 295.

<sup>30</sup> *Supra* note 25.

<sup>31</sup> *Supra* note 29.

<sup>32</sup> Duncan Wallace, “Hudson’s Building and Engineering Contracts.” Eleventh Edition. (London: Sweet & Maxwell, 1995), p.623.

<sup>33</sup> *Supra* note 4.

Various acts by the employer can result in a repudiatory breach and thus entitle the contractor to terminate the contract.<sup>34</sup> A party contemplating to terminate a contract following a breach by the other party must necessarily consider the nature and magnitude of the breach.<sup>35</sup> The remedy for non-payment if it constitutes repudiation is to terminate the contract pursuant to express termination provisions in the contract, or rescission at common law for a breach going to the root of the contract, or suing for interim payments or requiring arbitration where that is provided. If the contractor chooses not to rescind or terminate, his own obligations continue and he is bound to go on with the work.<sup>36</sup>

In a nutshell, the contractor alleges that his cash flow is seriously disturbed when the employer fails to make payment. As a consequence, he treats this as a repudiatory breach by the employer and chooses to stop his work at the site because he is not able to fund the project without the employer paying for his works. However, it is later held that the employer's breach is not sufficiently serious to justify the contractor in stopping his work. This mistake means that the contractor is now guilty of a repudiatory breach, and the employer is entitled to terminate the contract. Therefore, the issue arises is, is non-payment by the employer sufficiently enough to be considered as a repudiatory breach?

From the above discussion, whether the failure to pay amounts to repudiation will depend on the circumstances of the case. Therefore, this study is to identify circumstances where non-payment by an employer constitutes a repudiatory breach of contract. Findings of this study will assist the contractor to understand his position before he takes action when the employer fails to make payment. The contractors need to know that whether they are entitled to terminate the contract when faced with non-payment by the employer.

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<sup>34</sup> *Supra* note 2, p.197.

<sup>35</sup> *Supra* note 25.

<sup>36</sup> *Supra* note 5.



### **1.3 Objective of the Research**

To identify circumstances where non-payment by an employer constitutes a repudiatory breach of contract.

### **1.4 Scope of the Research**

Given the legalistic nature of this study, the approach adopted in this research is case law based. Only cases specifically centered on issue of non-payment will be discussed in this study. Types of contract involved include construction contracts (between employer and main contractor, and between main contractor and subcontractor) and contracts of sales of goods and land.

### **1.5 Importance of the Research**

The purpose of this study is to give an insight into the non-payment issue. It is hoped that the findings of this study will assist the contractors to understand their rights in the non-payment issue without making mistake in terminating the contract. It will also help the players in the construction industry to understand their positions in this issue.

## 1.6 Research Methodology

Careful thought and planning in the preparation of the research methods, data collection techniques and measurements is very important for conducting research. Initially, a literature review was undertaken to study and understand the problems of non-payment in construction industry and review the contractual provisions in relation to payment in building contract. It was carried out using published journals, textbooks and standard form of building contracts.

In order to meet the goals and objectives, the primary data collection was based on the Malaysia Law Journal (MLJ) court cases. It was carried out using the university's library online e-database<sup>37</sup> via the *Lexis-Nexis* website<sup>38</sup>. The selection of sample court cases involved a depth study rather than a random sample.

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<sup>37</sup> <http://www.psz.utm.my>

<sup>38</sup> <http://www.lexisnexis.com>