

ARBITRATION AGREEMENT IN SUBCONTRACT:
INCORPORATION BY REFERENCE

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Dissertation Submitted in Fulfillment of the Requirement for the Award of Master of
Construction Contract Management

Faculty of Built Environment
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Sept 2016

ACKNOWLEDGEMENTS

All praise be to the Lord, the All - Knowing Allah, the source of all knowledge, for His guidance and munificence in helping me in my quest for knowledge and to persevere in the course of completing of this study.

I wish to first acknowledge and express my sincerest gratitude to the supervisor of my research, Mr.Jamaluddin Yaakob, for his advice, constructive criticism and efforts to improve my research. The counsels motivated me and the criticisms have made me more determined to enhance my knowledge.

To my family who has been my inspiration, I dedicate my thanks and my love. Knowing and unknowingly, my family have been instrumental in supporting and encouraging me to make this research a valuable informative experience. They were my motivation and purpose.

I would also like to thank to special one, Nurul Iman. Helping me in making sure that this study is a success. I humbly accept that I could never have completed the research without the help of others and I earnestly convey my gratefulness.

ABSTRACT

Contracting parties in all industries often employ the Incorporation By Reference (IBR) practice and use arbitration as the method to resolve their disputes. However, these practices are not without issues. There are arguments for and against them. The most disputed subject is when an arbitration clause is incorporated by reference from one contract to another. In Malaysia, the ruling is that a general statement of incorporation is enough to signify intent of Incorporation by Reference of an arbitration clause. To examine further on the issue, this qualitative study presents a critical analysis of 15 legal cases in Malaysia so as to identify the IBR principles practiced that affect the jurisdiction, whether to accept or reject the case. The law cases were primary sources reported in *Malayan Law Journal (MLJ)* which were retrieve from online the database of LexisNexis legal search engine. The method employed was legal research methodology that focused on descriptive analysis of law in lifting out the facts and judges' scrutiny of the cases. The findings showed that in Malaysia, under the Arbitration Act 2005, there are three significant IBR principles being exercised by judges namely document need to be clearly identified, document clearly drafted and document need to be accessible. Based on the findings, it is hoped that before venturing into any contract, the parties involved will have clearer picture on what to do and what precautions to be taken against risks of dispute.

ABSTRAK

Dalam kebanyakan industri, Diperbadankan dengan Rujukan (IBR) sering menjadi pilihan dan dilaksanakan dalam menyelesaikan pertikaian antara pihak yang terlibat. Walau bagaimanapun, terdapat hujah-hujah yang menentang penggunaan IBR sebagai alternatif penyelesaian. Antaranya adalah apabila satu klausa timbangtara diperbadankan dengan rujukan antara kontrak perjanjian yang wujud. Di Malaysia, praktis yang digunapakai adalah jika wujud satu pernyataan umum menggabungkan IBR, itu sudah cukup untuk menunjukkan pelaksanaan IBR dalam klausa timbangtara. Dalam mengkaji isu ini, kajian kualitatif ini membentangkan analisis kritikal terhadap 15 kes undang-undang Malaysia yang diambil dari *Malayan Law Journal (MLJ)* yang boleh diakses dari carian LexisNexis. Kaedah yang diguna adalah metodologi penyelidikan undang-undang yang fokus kepada analisis deskriptif dalam mengolah fakta-fakta kes dan keputusan hakim terhadap kes. Hasil dapatan menunjukkan terdapat tiga prinsip IBR yang ketara yang digunapakai di Malaysia dibawah Akta Timbang Tara 2012 iaitu dokumen perlu dikenalpasti dengan jelas, dokumen jelas digubal dan dokumen perlu boleh diakses. Berdasarkan kajian ini, adalah diharapkan bahawa sebelum menyertai mana-mana kontrak, pihak yang terlibat akan mempunyai gambaran yang lebih jelas mengenai apa yang perlu dilakukan dan apa langkah berjaga-jaga yang perlu diambil terhadap risiko pertikaian.

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LIST OF CASES

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**RE KHOR HOI CHOY KHOR HOI CHOY V MENTERI DALAM NEGERI
MALAYSIA & ORS**

**SOCIETE GENERALE V GOOD PROPERTY LAND DEVELOPMENT PTE
LTD**

KIEN TAD SDN BHD V KLOCKNER INDUSTRIE-ANLAGEN GMBH [

**SYARIKAT GEMAS PALM OIL TRADING V ALCAN GETAH MALAYSIA
SDN BHD**

**VISIA FINANCE BHD V MENANG-SK BROTHERS ENTERPRISE SDN
BHD & ANOR**

**RAJA ZAINAL ABIDIN BIN RAJA HAJI TACHIK & ORS V BRITISH-
AMERICAN LIFE & GENERAL INSURANCE BHD**

**LION ENGINEERING SDN BHD V PAUCHUAN DEVELOPMENT SDN
BHD**

BAUER (M) SDN BHD V DAEWOO CORP

USAHASAMA SPNB-LTAT SDN BHD V BORNEO SYNERGY (M) SDN BHD

ALBILT RESOURCES SDN BHD V CASARIA CONSTRUCTION SDN BHD

**TNB FUEL SERVICES SDN BHD V CHINA NATIONAL COAL GROUP
CORP**

**AJWA FOR FOOD INDUSTRIES CO (MIGOP), EGYPT V PACIFIC INTER-
LINK SDN BHD**

CTI GROUP INC V INTERNATIONAL BULK CARRIER SPA

**Y & Y PROPERTY DEVELOPMENT SDN BHD V CITY-LITE LETRIK SDN
CLLS POWER SYSTEM SDN BHD V SARA TIMUR SDN BHD**

LIST OF ABBREVIATION

AC	Law Report Appeal Cases
ADR	Alternative Dispute Resolution
ALL ER	All England Law Report Building Law Report
CIDB	Construction Industry Development Board
IEM	The Institute of Engineers, Malaysia
MLJ	Malayan Law Journal
MLJU	Malayan Law Journal Unreported
PAM	Pertubuhan Arkitek Malaysia
PWD	Public Work Department
RM	Ringgit Malaysia
RIBA	The Royal Institute of British Architects
ADR	Alternative Dispute Resolution
UNICTRAL	Model Law on International Commercial Arbitration
ICC	International Chamber of Commerce
ICSID	International Center for the Settlement of Investment Disputes
LCIA	London Court of International Arbitration

CHAPTER 1

INTRODUCTION

1.1 Introduction

Incorporation by reference is a document or publication, be it a standard form of contract, technical specifications or similar publication without retyping the whole document in order to form part of the agreement.¹ It is not to be confused with an implied term because the reference is made to a specific document while implied terms, on the other hand, are those introduced by the courts under common law or by reference to an act.² Compared to reference, implied terms are not so included within a contract although they are significant in influencing the obvious intentions of the parties to the contract.

An example of incorporation by reference is clause 66.0 of PWD 2010. Sub-clause 66.3(b)

“...such arbitration Shall be conducted in accordance with the rules for arbitration of Kuala Lumpur Regional Centre for Arbitration...”

¹ Keating on Construction Contract (8th Ed) by S. Furst p.403-5

² Syarikat Gemas Palm Oil Trading v. Alcan Getah Malaysia Sdn Bhd

A term may be incorporated by reference to another contract document if there is an express or implied agreement to that effect, provided the term is not inconsistent with the contract into which it is alleged to have been incorporated.³

Contract document is referred to the bills of quantities, articles of agreement, letter of award, treasury instruction, etc. as stated in clauses in 1.1 (b) of PWD 203A (Revised 2010)⁴ and article 7(q) of PAM 2006⁵. In any fields, the three main parties involved, which are employer, main contractor and sub contractor, would not be directly connected or bound by agreement.⁶ Having to work together in one project (assuming having one similar aim), incorporation by reference is therefore the suitable way to connect or bound all parties in an agreement.⁷

Let us familiarize ourselves with a common contract issue story in the construction industry. A contract is agreed between the owner and the main contractor, and the main contractor that attempts to incorporate the terms of the main contract into its contract with the subcontractor. Since the provisions of the main contract are drafted to suit the circumstances of the owner and the contractor, there is every reason for the subcontractor not to agree, to the terms of the main contract being incorporated into the subcontracts. This is especially so where the main contract may contain provisions such as liquidated damages, an arbitration clause, and other specific provisions with respect to security, insurance and removal of aliens which may be wholly suitable for the owner and contractor, but totally unsuitable to the subcontractors. For example, the contractor may give the owner a specific one-year guarantee but there is no concrete reason why the subcontractor should be bound by that guarantee. The relationship involves three main parties and two contracts (in a simplified world), thus, the contracts need to address the interests of all three parties.

³ [www.fenwickelliott.co.uk/subcontracts/incorporation by reference](http://www.fenwickelliott.co.uk/subcontracts/incorporation%20by%20reference)

⁴ PWD 203A (2010)

⁵ PAM 2006

⁶ Sunner Corner Enterprises Inc v. Dustex Corporation

⁷ IEM Conditions of Contract for Works Mainly of Civil Engineering Construction First Edition May 1989 (Second Re-print Sept 1994)

Nonetheless, incorporation by reference, if done in a proper way, is a suitable way to connect or bound all parties in an agreement. Incorporation of documents in one contract into another between the three parties can make the same rules apply to all of them. It is quite common for parties to record the bare essentials of their contract in a document and for that document to refer to, and incorporate, a set of terms, such as the standard form of a trade association, or the standard terms of one of the parties need to be used.⁸ However, the incorporation must be the subject of express or implied agreement, and a communication purporting to accept an offer will not incorporate terms as set out in a contract note where these differ from the terms of the offer.⁹ The approach may also be used to incorporate the terms of another contract related to the transaction.¹⁰

The general approach is that the terms must be connected to the contract.¹¹ An arbitration clause is not necessarily incorporated by this process.¹² For purpose of avoiding any misunderstanding, it is important that the specific document that the parties wish to be incorporated describes accurately, as well as stating the correct version.¹³

The meaning of the words in the incorporated document is one of construction and the words in the express contract will not necessarily bear the same be incorporated by reference to another contract or document if meaning as in the incorporated document.¹⁴ If the effect is to incorporate provisions inconsistent with the express contract, written terms will prevail. The issue is ultimately the construction of the incorporating document that intends to bind all related parties.

⁸ Thomas G. Heintzman, Incorporation by reference In Building Contract

⁹ Thomas G. Heintzman OC, QC, FCI Arb is counsel and Julie Parla is a partner in the Toronto office of McCarthy Tetrault LLP.

¹⁰ Duane Morris LLP “contractor beware: that “flow-down clause” may not flow as far as you think” : Cases- Wonder Works Construction Corp v. R.C Dolner, Inc.,

¹¹ Albiat Resources Sdn Bhd v. Casaria Construction Sdn Bhd – MLJU 346

¹² Y&Y Property Development Sdn Bhd v. City-Lite Letrik Sdn Bhd –MLJ 411

¹³ E.g. “IEM Conditions of Contract for Works Mainly of Civil Engineering Construction First Edition May 1989 (Second Re-print Sept 1994)

¹⁴ 1510610 Ontario Inc. v. Man-Shield (NOW) Construction Inc,

Incorporation by reference of arbitration clauses may also be subject to the governing arbitration statute. Thus, the UNCITRAL Model Law, which is incorporated into the various provincial and federal statutes applicable to international commercial arbitrations¹⁵ states as follows:

“The reference in a contract to any document containing an arbitration clause constitutes an arbitration agreement in writing, provided that the reference is such as to make that clause part of the contract.”

A common source of difficulty in arriving at the true intention of the parties will be where a document referred to by reference for a particular purpose also contains an arbitration clause which one of the parties seeks to invoke. The incorporation by reference of arbitration clauses from one contract to another has been the subject of a number of cases in the United Kingdom and Australia.¹⁶

In incorporating a specific document by reference with the other document which form the agreement, it is important to determine the order of precedence. For instance, if one party tries to incorporate by reference a form of general conditions of contract, in terms of priority, that party will be listed higher in the list, however lower than the form of Agreement.

Form of agreement listing documents which supposed to be incorporated into the agreement normally involves technical specification such as building standards, testing standards, materials and product standards. All those standards can be both from professional bodies and from product data sheets or catalogues of product manufacturing or supply companies.

¹⁵See, for instance, the Ontario *International Commercial Arbitration Act*, R.S.O. 1990, c. I.9, Article 7(2) of the Model Law attached to that Act The domestic Ontario Act, the *Arbitration Act*, 1991 ,S.O. 1991, c. 17 does not contain a provision that directly deals with incorporation by reference of an arbitration clause from one contract or document into a second contract. Section 5(1) does say that an arbitration agreement “may be an independent agreement or part of another agreement”.

¹⁶ Rebecca James and Michael Schoenberg, “Incorporating an Arbitration Clause ‘By Reference’: Reconciling Model Law Article VII and Australian Common Law in Light of Recent Developments”, (2011) 77 *Arbitration*, Issue I, 84. (“James and Schoenberg”)

1.2 Background of the Study

A contract is central to the working relationship between parties in a commercial deal. Often a done deal is celebrated but the euphoria of a done deal contrasts sadly with the acrimony that befuddles the disputes which regularly follow. A contract must prepare the parties for disputes that may arise no matter how affable the relationship between the parties is. The lawyers are therefore entrusted with crafting a contract which best suits both (or more) parties.

Dispute resolution is the central theme of this study and from with the wide range of dispute resolution options available, the researcher focuses on arbitration. In addition, the study looks into the practice of incorporation by reference in drafting contracts. While the focus is on the construction industry, the study include analysis of other industries since the nature of conflicts do not differ much across industries.

These days, when two disputed parties looking for resolution mechanism, normally they will undergo few steps that end with one party choose the binding resolution. Take this scenario as example; one multi-tiered organization is having an argument. The first effort in looking for solution is by having negotiation that usually involves only the top guns of both concerned parties. However, if the first step fails to resolve the issue, mediation will be the second alternative. And if that fails, arbitration will be of functional in settling the dispute. It is often believed that the final resolution should be concluding and binding between the parties. Therefore it is essential for both parties to be informed on the arbitration clause in a contract and the wording must be clear-cut so that it would not be interpreted otherwise. The importance of arbitration clause is not to be underestimated and this study highlights the issue both theoretically and practically.

The second concept focused in the study is incorporation by reference. Incorporation by reference is a document or publication whether it is a standard form of contract, technical specifications or similar publication without a retype of the whole document in order to form part of the agreement¹⁷. With great developments in the world of business and commerce, the use of contracts has greatly expanded and it has become very technical, detailed and sophisticated. Contract writing becomes more and more complicated with more documents and details need inclusion. Incorporation by reference alleviates much of this problem. It allows legal practitioners to include whole documents which are referable into contracts and these documents will have the same weight as other words in the contract. This concept is very useful and as such a study on this matter is imperative both for the academics and practitioners.

The third element, as obvious in the title, is subcontract. The subcontractors are the executioners of most activities in construction projects and as such deserve a lot of attention by legal practitioners and academics and more so by the drafters of contracts. Disputes between the main contractor and the subcontractor often occur. Thus, the dispute resolution mechanism must be made clear in the contract. And it must be clear as well if there are any documents or terms incorporated from the main contract between the owner and the main contractor into the subcontract. Should both parties agree to arbitration, it must be clearly stated in the subcontract.

To begin the dissertation, it is only natural to explain the definitions of the key concepts which will be repeated throughout the dissertation.

¹⁷ Keating on Construction Contract (8th Ed) by S. Furst p.403-5

a) Arbitration Agreement

A contract between two or more parties to refer a dispute to arbitration related to the performance of a specific contract, a claim of unfair or illegal treatment in the workplace, a faulty product, among other various issues.

b) Incorporation by Reference

The terms of a contemporaneous or earlier writing, instrument, or document capable of being identified can be made an actual part of another writing, instrument, or document by referring to, identifying, and adopting the former as part of the latter.

c) Subcontract

A legal agreement by which you hire another person or company to do part of a job you have been hired to do.

1.3 Problem Statement

Incorporation by Reference will only occur if the objective intention of the parties was to incorporate one document into another. While this principle is sometimes stated to be based on the subjective intention of the parties, that approach is contrary

to the fundamental principle of contract law that intention is to be objectively determined.¹⁸

Since the provisions of the main contract are drafted to suit the circumstances of the owner and the contractor, there is every reason for the subcontractor not to agree entirely to the terms of the main contract being incorporated into the subcontract. This is especially so where the main contract may contain provisions such as liquidated damages, an arbitration clause and other specific provisions with respect to security, insurance and removal of liens which may be wholly suitable to the owner and contractor, but totally unsuitable to the subcontractor. Some examples from the cases referred to above make this point clear. For example, in *Q.Q.R. Mechanical Contracting Ltd. v. Panther Controls Ltd.*¹⁹, the contractor had given the owner a specific two-year guarantee. There does not seem to be much reason why the subcontractor should be bound by that guarantee.

It is different with what had happened to the cases, *Modern Buildings Wales Ltd v. Limmer & Trinidad Co Ltd* [1975] 2 Lloyds R 318,²⁰ The main contractors (plaintiffs) placed a written order with the nominated subcontractors (defendants)

*“To supply adequate labour, plant and machinery to carry out, complete, the ventilated and non-ventilated ceilings at the contract site within the period stipulated in the programme of work and in full accordance with appropriate form for nominated subcontractors (RIBA 1965 Edition)...”*²¹

¹⁸ Heintzman and Goldsmith on Canadian Building Contracts, Chapter 1, Part 1(b)

¹⁹ *Q.Q.R. Mechanical Contracting Ltd. v. Panther Controls Ltd*

²⁰ *Modern Buildings Wales Ltd v. Limmer & Trinidad Co Ltd* [1975]

²¹ The Royal Institute of British Architects (1965)

The plaintiffs contended that their order did not refer to the green form. The green form is actually a form of contract to be used by contractors and nominated subcontractors under the 1963 Edition of the RIBA form of main contract. By not referring to the green form, the plaintiffs doubt whether the arbitration agreement had been incorporated or not, thus giving them good basis for further action to proceed. The plaintiffs began an action for damages for breach of contract and applied for summary judgment under RSC Order 14. The defendants then applied to stay the action on ground under Section 4(1) of the Arbitration Act 1950 which mention that the written order incorporated the green form which contained an arbitration clause.

Although the green form had been issued in 1963 by the National Federation of Building Trades Employers and the Federation of Associations of Specialists and Subcontractors, the similar form did not replicated and applied in 1965. This resulted in the Royal Institute of British Architects (RIBA) had no standard form of contract between a contractor and a nominated subcontractor.

If the parties are in a direct relationship with each other, then Incorporation by Reference will be more sustainable. Hence, if it is a question of incorporating a letter of intent or the terms of a tender into the contract which is ultimately made by the same parties who exchanged the letter of intent or participated in the tender, or incorporating the terms of a contract into a performance or payment bond relating to that contract, then a court will be much more likely to hold that the Incorporation by Reference clause is effective to bring all of the material portion of the other document into the contract.²² In analyzing cases related to IBR, commonly two questions evolved which are;²³

²² Foundation Co. of Canada v. United Green Growers Ltd (1997), 33 C.L.R (2d) 159 (B.C.C.A.); Pozzebon v Lamanatea, 1988 Carwell Ont. 759 at para. 4; Whitby Landmark Development Inc. v Mollenhauer Construction Ltd.,(2003) 26 C.L.R (3d) 161 (Ont. C.A.)

²³ Thomas G. Heintzman “Is a Subcontractor Bound By the Arbitration Clause in the Main Contract?”

- a) Is a subcontractor bound by the arbitration clause in the main contract?
- b) When is the main building contract incorporated by reference into the subcontractor?

In view of the above issue, it is so crucial for them to be considered when drafting the details and ingredient of an arbitration clause in a new contract.

1.4 Research Objective

The study aims to achieve the objective as below.

- a) To identify principles of Incorporation by Reference in Arbitration Agreement employed in the cases

1.5 Research Question

To be more specific this study attempted to answer the following research question:

- a) What are the principles of Incorporation by Reference in Arbitration Agreement employed in the cases?

1.6 Significance of the Study

The researcher believes that this study will be able to benefit both practitioners and academicians in any fields relating to subcontracts. The information

gathered, particularly on incorporation by reference in relation to arbitration in subcontract can be used by the legal firms to make the documents more concrete, fair and binding to all parties involved. Besides that, the analyses on local cases will undoubtedly helpful in giving insights to people of the industry to determine the best practice that can be most beneficial in Malaysia.

1.7 Scope of the Study

The study does not limit itself to studying arbitration and incorporation by reference in construction industry although much of the focus theoretically and case-wise is as such. The researcher deemed that it is useful to gather information and widen the scope of to include various industries such commercial business, shipping, insurance, property development etc. which use incorporation by reference approach and arbitration clauses. The rationale is that the nature of disputes that constantly arise in different industries are quite similar, thus the probability of similar issues arising in the construction industry is quite high. Moreover, except for jargons and technicalities, businesses in any industry are quite similar in contract handling and thus it is useful to study the different industries.

1.8 Chapters Organization

The chapters of dissertation are as follows:

Chapter 1: Introduction

Chapter one introduces the study beginning with its background, followed by the problem statement, research objective and question, significance of the study, the scope of the study and the limitations of the study.

Chapter 2: Arbitration Agreement

Chapter two explicates the review of literature on the theoretical aspects of Arbitration Agreement including arguments for and against it, the processes involved, agreement drafting and arbitration laws in Malaysia.

Chapter 3: Incorporation by Reference

Chapter three elucidates the theoretical aspects of the issue central to the study which is Incorporation by Reference (IBR). It covers the definition, history, common issues regarding IBR as well as the documentation of IBR in standard forms in Malaysian Construction Industry.

Chapter 4: Research Methodology

Chapter four explains the research methodology utilized in this study that helps in answering the research question.

Chapter 5: Critical Analysis of Cases

Chapter five presents the critical analysis of the cases in revealing the IBR principles being employed affecting arbitration decision in employer/main contractor or subcontractor.

Chapter 6: Conclusion and recommendation

Chapter six concludes the dissertation and includes recommendations for best practice and future studies.

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