

THE PROFILE OF CONTRACTUAL ISSUES ASSOCIATED WITH
SUBCONTRACTS IN MALAYSIAN CONSTRUCTION INDUSTRY

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ABSTRACT

Subcontracting is a common practice in construction especially when it involves the specialist works. It is normal for the main contractors to subcontract part or all of the work under the main contract to domestic or nominated subcontractors. However, the complexity of construction process, together with high demand and expectation by the employer had exposed the subcontract works with the risk of disputes. The disputes involving subcontracts are also very much a part of the seemingly ever increasing litigations in the construction industry. The main objective of this research is to develop a profile of contractual issues associated with subcontracts in the Malaysian construction industry. The study is limited to subcontract cases in the Malaysian court between 1974 to 2012. Altogether 59 court cases were selected and analysed. This study highlighted that there are 19 common contractual issues associated with subcontracting. Out of these, 10 cases of non-payment by the main contractor have been identified as the most significant issues that led to the disputes. The study also suggested that the majority of cases involve main contractors and domestic subcontractors with 29 cases, where non-performance by the subcontractor found as the major issue. Followed by main contractors and nominated subcontractors with 10 cases where non-payment by the main contractor remains as the major issue. The study also shows that the defendants in the cases are mainly main contractors. It is hoped that the profile will provide a useful knowledge and guideline for improving construction contract planning and implementation.

ABSTRAK

Subkontrak adalah merupakan amalan biasa dalam pembinaan terutamanya apabila melibatkan kerja-kerja pakar. Ia adalah normal bagi kontraktor utama untuk mengsubkontrakkan sebahagian atau keseluruhan kerja di bawah kontrak utama kepada subkontraktor domestik atau dinamakan. Walaubagaimanapun, kerumitan proses pembinaan, berserta dengan permintaan dan jangkaan yang tinggi oleh pihak majikan, telah mendedahkan kerja-kerja subkontrak dengan risiko pertikaian. Pertikaian yang melibatkan subkontrak juga merupakan sebahagian daripada peningkatan litigasi di dalam industri pembinaan. Objektif utama kajian ini adalah untuk membina profil bagi isu-isu kontrak yang berkait dengan subkontrak dalam industri pembinaan di Malaysia. Kajian ini adalah dihadkan kepada kes-kes subkontrak di dalam Mahkamah Malaysia di antara 1974 hingga 2012. Kesemua 59 kes mahkamah telah dipilih dan dianalisis. Kajian ini menjelaskan bahawa terdapat 19 isu-isu kontrak yang berkait dengan subkontrak. Daripada isu-isu ini, 10 kes kegagalan membayar oleh kontraktor utama telah dikenalpasti sebagai isu kontrak yang paling ketara yang mencetuskan pertikaian. Kajian juga menyatakan bahawa majoriti kes adalah melibatkan kontraktor utama dan domestik subkontraktor dengan 29 kes, di mana isu tiada prestasi oleh subkontraktor sebagai isu utama. Diikuti dengan kontraktor utama dan subkontraktor dinamakan dengan 10 kes, di mana isu tiada bayaran dari kontraktor utama sebagai isu utama. Kajian turut menunjukkan defenden dalam kes-kes tersebut kebanyakan adalah kontraktor utama. Adalah diharapkan dengan adanya profil ini dapat memberikan ilmu pengetahuan dan panduan berguna bagi meningkatkan dari segi perancangan dan pelaksanaan kontrak pembinaan.

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LIST OF ABBREVIATIONS

AC	Law Reports: Appeal Cases
AMR	All Malaysia Reports
CIDB	Construction Industry Development Board
CLJ	Current Law Journal (Malaysia)
DSC	Domestic Subcontractor
FC	Federal Court
FMSLR	Federated Malay States Law Reports
HL	House of Lords
HKC	Hong Kong Case
HKLR	Hong Kong Law Reports
IEM	The Institution of Engineers, Malaysia
ISM	The Institution of Surveyors, Malaysia
JKR	Jabatan Kerja Raya
LAD	Liquidated and Ascertained Damages
MBAM	Master Builders Association
MLJ	Malayan Law Journal
NSC	Nominated Subcontractor
PAM	Pertubuhan Arkitek Malaysia
PWD	Public Work Development

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CHAPTER 1

INTRODUCTION

1.1. Background of Study

Construction industry is a large, dynamic and complex industry which involves numerous parties, various processes, different phases and stages of works, and many inputs from both the public and private sectors.¹ The inputs used for a project are including the raw materials such as bricks, cement and sand, the labour forces, the plant and machineries, the land and many others for the building to be constructed. Besides that, there are also various parties such as employers, main contractors, subcontractors, design consultants and suppliers which are grouped together to perform their duties and obligations towards the project.² Their connection basically begins from a single contract normally addressed as the 'Main Contract' which binds the employer and main contractor, before other types of contract comes into picture.

¹ Bernard T.H. Wang (1987), *Construction and Development (With Reference To Malaysia)*, Petaling Jaya, Selangor: Pelanduk Publication (M) Sdn Bhd

² Teresa Cheng, Evia Wong & Gary Soo (2004), *Construction Law and Practice in Hong Kong*, Causeway Bay, Hong Kong: Sweet & Maxwell Asia

Besides the employer and main contractor, the parties that are involved in a construction project are the team of consultant which consists of the Architect, Quantity Surveyors, Engineers and etc., the subcontractors, the suppliers, the service providers and many others that are relevant and applicable for the projects. The relationship between all of these parties with the employer and main contractor are depends on the types of contract that they enter into, such as contract for supply of goods, contract for supply and install, contract for services, contract for performing works, etc.

A subcontractor is one of the parties that a main contractor appoints to undertake part or all works under the main contract.³ There are two types of subcontractor namely 'Nominated Subcontractor' and 'Domestic Subcontractor'.⁴ A nominated subcontractor is a subcontractor that the employer selects and nominates for the main contractor to enter into a subcontract.⁵ A domestic subcontractor is another type of subcontractor in which the employer plays no part in selection and appointment, where the main contractor appoints or engages entirely for his or her benefit, a purely 'domestic' matter.⁶ However, their objective towards the project is the same that is to complete the work based on their specialties, skills and workforce for the completion of the project.

Nominated subcontractors are normally selected by the employer for the specialist works under Prime Cost or Provisional Cost Sum to ensure the quality and outcome of the works or products. Whereas a domestic subcontractor is appointed by the main contractor to carry out different trade of works under the main contract such as

³ Lew Yoke-Lian, S. Hassim, R. Muniandy, and Law Teik-Hua (2012), *Review of Subcontracting Practice in Construction Industry*, IACSIT International Journal of Engineering and Technology, Vol. 4, No. 4, p.442

⁴ Nor Marina Binti Rosli (2006), *The Use Of Standard Form Of Domestic Subcontract In Malaysian*, Universiti Teknologi Malaysia.

⁵ Allan Ashworth (1985), *Contractual Procedures in the Construction Industry* (4th ed.), Tottenham Court Road, London: Pearson Education

⁶ John Murdoch and Will Hughes (1992), *Construction Contracts: Law and Management* (3rd ed.), New Fatter Lane, London: Spon Press

subcontract for the brickwork, plastering work, cement rendering work, carpentry works, joinery works and etc.

The number of subcontractors within a project varies depending on the type and size of the project, the volume of works, the time period for project completion and the requirement by the employer. The involvement of different types of subcontractors in a project however requires a very good management and coordination at site. The success of a project is strongly based on the efficiency of the project manager and the main contractor in coordinating the works of different subcontractors.

Unfortunately, over the past thirty years or so, construction disputes have generated increased interest. The advent of main contractor outsourcing much of the construction process to subcontractors created another source of disputes, particularly about payment.⁷ There are many legal and contractual issues resulting from the disputes. Failure to manage the disputes may put a project into risk of delay, suspension of work, termination or non completion. Disputes are likely to happen due to various reasons such as poor communication, poor planning, delayed payments, design inadequacies, etc.⁸

Dispute in construction projects is a normal occurrence.⁹ Some disputes can be resolved during the construction stage, while others may be dragged even until the project completed or uncompleted. Generally, the nature of construction industry which is unique and complex with participations of human factor such as mistakes, needs,

⁷ Peter Hibberd and Paul Newman (1999), *ADR and Adjudication in Construction Disputes*, Osney Mead, Oxford: Blackwell Science

⁸ Allan Ashworth (1985), *Contractual Procedures in the Construction Industry* (4th ed.), Tottenham Court Road, London: Pearson Education

⁹ Asniah binti Abidin (2007), *The Profile of Construction Disputes*, M.Sc of Construction Contract Management, Faculty of Built Environment, Universiti Teknologi Malaysia (UTM)

and/or requirement have trigger for such disputes to occur. The disputes between the parties may take place in terms of technical, contractual or commercial. They must be settled before they prolong and affects the completion of the work. There are numerous of Malaysian court cases involving various parties in the construction industry due to the unresolved disputes.

1.2. Problem Statement

The disputes involving the subcontractors, main contractors and employers are very common in the industry. The disputes tend to happen due to several reasons such as changes in nature of works, discrepancies in the contract document, variation orders by the employers, restriction by the local authority, changes in rules and regulations, and many more. Unable to foresee on such circumstances to happen will definitely affect the subcontract and bring the parties into series of discussion and argument. At the end of discussion, adjustment or additional condition may be applied in order to protect the spirits of the contract.

Unfortunately, not all disputes which arise during the construction can be resolved immediately, where some were even drawn out until the end of completion period.¹⁰ The project might be able to survive and completed, but the involved parties in the disputes might suffer loses or damages due to the disputes. The owner might also have to pay higher price for the project to be completed. As the owner of the project, he also tries to avoid any disputes during the construction and do not want lengthy litigation process in resolving the disputes.

¹⁰ Bernard T.H. Wang (1987), *Construction and Development (With Reference To Malaysia)*, Petaling Jaya, Selangor: Pelanduk Publication (M) Sdn Bhd

According to Lew *et al* (2012),¹¹ problem related to subcontractors are still quoted as one of the main risk in the construction project globally. The same applies to Malaysian construction industry where problem with subcontractors have been identified as one of the important causes contributing to delays. Mouton and Johnston (1989),¹² stated that subcontracting contains its own specialized set of rules, techniques and problems; claims and disputes in subcontracting are inevitable in construction.

Several studies related to subcontracting practice which were conducted in Malaysia showed that it is creating problems to the construction industry. According to Sambasivan and Soon (2007),¹³ there are many subcontractors working under the general contractors especially for big scale projects in Malaysia, but are found to be among the top five reasons contributing to project delay. Another study by Alaghbari, Kadir, and Salim (2007),¹⁴ suggested that lack of skill among subcontractors as one of the factors contributing in contractor's delay in 78 construction projects studied in Malaysia. Besides causing delay, problem with subcontractor's coordination were also found as one of factors that affect the construction labour productivity of residential projects in Malaysia.¹⁵

¹¹ Lew Yoke-Lian, S. Hassim, R. Muniandy, and Law Teik-Hua (2012), *Review of Subcontracting Practice in Construction Industry*, IACSIT International Journal of Engineering and Technology, Vol. 4, No. 4, p.443

¹² Mouton, J and Johnston, H (1989) *Construction Subcontracting As An Educational Topic*. ASC Proceedings of the 25th Annual Conference. San Luis Obispo, California: California Polytechnic State University. p87-94

¹³ M. Sambasivan and Y. W. Soon (2007), *Causes and effects of delays in Malaysian Construction Industry*, International Journal of Project Management, vol. 25, p.517-526.

¹⁴ W. E. Alaghbari, M. R. A. Kadir, and A. Salim (2007), *The Significant Factors Causing Delay of Building Construction Projects in Malaysia*, Engineering, Construction and Architectural Management, vol. 14, p.192-206.

¹⁵ M. R. Kadir, W. P. Lee, M.S. Jaafar, S. M. Sapuan, and A. A. A. Ali (2005), *Factors Affecting Construction Labour Productivity for Malaysian Residential Projects*, Structural Survey, vol. 23, pp. 42-54.

Besides that, the disputes involving subcontracting are also very much a part of the seemingly ever increasing litigious of the construction industry. (Currie *et al*, 1991). It is well known that disputes are likely to occur between the subcontractors and general contractors in order to achieve the targeted objectives of cost, quality and time. (Mohamed Asem and Zeina, 2001). Other than that, it was stated in Construction Claims Monthly (1986) that, “no issues are of broader concern to the construction industry other than the issues arising out the relationship between prime contractors and their subcontractors.” Relationship between general contractor and subcontractor constitute a large proportion of the disputes in the construction industry (Proctor, 1996).

It can be summarised that, disputes associated with subcontractors or subcontract works are numerous and increasing as project are getting bigger and more sophisticated and complex. The question now, which contractual issues is actually the common subject matter of construction disputes in subcontracting. There are various contractual issues involving the subcontract works such payment problems, variations, discrepancies with main contract, set-off and many more. Since the disputes and contractual issues are one of the major factors that are affecting a project’s cost and completion, it is necessary to determine the profile of the contractual issues that occur in the subcontract works.

Asniah Abidin (2007) in her study on developing the profiles of construction disputes occurring in Malaysia had identified that the most common nature of construction disputes is payment. In particular, the disputes are related to non-payment of certified sums and making payment not according to terms of contract¹⁶. However, the profiling developed has a time limitation that was between the years of 1997 to 2007. Therefore, to provide more thorough and conclusive on the legal or contractual issues occurs in the construction industry which focuses on the subcontract, further

¹⁶ Asniah binti Abidin (2007), *The Profile of Construction Disputes*, M.Sc of Construction Contract Management, Faculty of Built Environment, Universiti Teknologi Malaysia (UTM)

study need to be carried out involving the earlier case law and new case law before and after the limitation. By having thorough knowledge and information, it will definitely will help the superintending officer and other project teams to anticipate problems and potential issues at the early stage of the project.

1.3. Previous Study

There is a precedent study by Asniah bt. Abidin in 2007. The objective of the research was to develop a profile of construction disputes that occur in Malaysia. Based on her research, the most common disputes that occur in Malaysia construction industry between the years 1997 until 2007 was the payment dispute (51%). In that study also, disputes or cases involving the main contractor and subcontractors was the second highest percentage with 17% in the most heavily involved in construction disputes after the main contractor and employer.

1.4. Objective of the Study

The objective of this study is to develop a profile of contractual issues associated with subcontracts in Malaysian construction industry.

1.5. Scope of the Study

The scope of this study is limited to Malaysian Court Cases, retrieved from Lexis Nexis, involving subcontract works in Malaysian construction industry between the years of 1974 to 2012.

1.6. Significance of the Study

Based on this study, the profiles of legal or contractual issues can be developed. From the profiles, the trends of legal or contractual issues can be identified and further action to overcome the issues can be taken. This profile also will act as indicator in construction industry to show the seriousness of certain legal or contractual issues in the industry. From here, the related industry's players will get information and takes action to improve the standard forms of contract, the rules and regulation, the governing laws. It is also important in construction contract management to anticipate the disputes at earlier stage of the project in order to prevent or minimized the possible legal or contractual issues.

Besides that, the related parties to the contract such as the employer, main contractor, subcontractor or supplier will be more responsible in carrying out their duty regularly and diligently, to apply close monitoring and supervision on the related works, and also to take pre-caution steps to reduce or prevent the same disputes from happen.

1.7. Research Methodology

In order to carry out the research, there are several stages or steps to be taken to provide more comprehensive and accurate data collection. The steps taken along the way is important to ensure the objective of this research is achieved. This is because, by having a proper steps or research methodology, it will ensure all information to be gathered proactively and precisely be analysed. The steps for this research are elaborated below:-

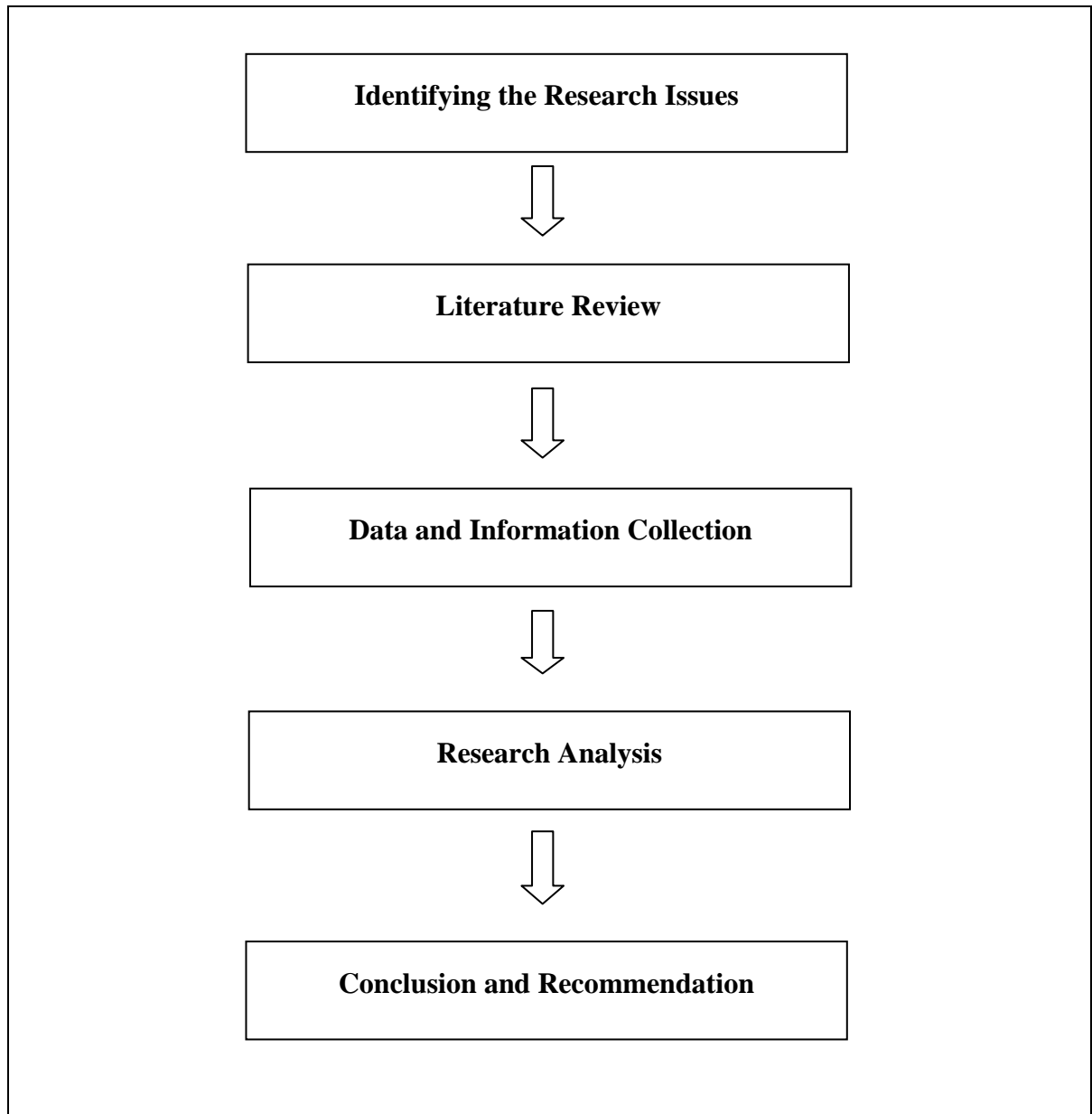


Figure 1.1: Research Methodology Diagram

1.7.1. Identify Research Issue

The first step is to identify the issues of the research topic and the objectives for the study. Proper planning and pre-discussion with the supervisor are very important at these stages where it will provide a better understanding and guidelines on how this research are to be carried out. From the discussion also, more idea on the area of study can be generated which will assists in determining the limitation or scope of the study.

1.7.2. Literature Review

It is also important for the preliminary study to be done either by discussion with related party or through readings and attending seminars regarding the research topic. Basically, literature review is one of the preliminary study where various sources of published materials like books, journals, seminar papers, articles, thesis, research report, newspaper, magazines and internet articles will be read and vet through. From this literature review, it will further explains on the background of the research topics, the issues associated with the topic, the objectives for such research to carried out and even the outcome or result of the research later.

1.7.3. Data and Information Collection

The next step for this research is data and information collection where there are two types of data knowing as primary and secondary data. This data and information collection is rather more crucial as the deciding factors on the objectives of the research. The types of primary and secondary data are explains below:-

1.7.3.1. Primary Data

The source of primary data is obtained from the seminar held by Board of Quantity Surveyors Malaysia on “Salient Clauses and Issues in PWD 203N Condition of Contract” by Sr. Amran bin Mohd Majid. This seminar answers the right procedures in implementing the PWD 203N standard forms of contract in the construction projects and also discussing the legal and/or contractual issues related to sub-contracting works.

1.7.3.2. Secondary Data

The source of secondary data is obtained from reported cases mainly from Lexis Nexis (Formerly known as Malayan Law Journal) and supported through reading and studying the published materials like standard forms of contract, books, journals, articles, thesis, newspaper, magazines, research report and etc. All of the court cases found from the secondary data are related to the contractual issues in subcontract works under Malaysian construction industry.

1.7.4. Research Analysis

Both data, primary and secondary are later be examined and analysed in order to achieve the research objectives. This was started with the case studies on the related legal court cases to identify the contractual issues in subcontract works under Malaysian construction industry. The analyses were conducted by reviewing and clarifying all the facts and issues of the cases.

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