

NOVATION AGREEMENT IN DESIGN AND BUILD CONTRACTS

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To my beloved Husband and son,

Thank you for your support, guidance and everything.

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In the name of Allah most gracious most merciful

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ABSTRACT

In the current market of Malaysia construction industry and among its players, the term 'design and build' is no longer require a proper launch as it has been in the implementation since the late 90's. However, the term 'novation agreement' in the design and build definitely requires a long and detail explanation. This is of course a new exercise in the local industry implemented massively by the semi-government holding company being the developer for a development of a territory. The implementation which grants the advantage on the part of the developer due to its mechanism has attracted other private employers to implement the same. This is because the traditional system has been revolutionized. Apart from providing single point responsibility by the procurement system, the employer can also take fully charge of the design prior to the tender stage and transfers his whole burden under the project to the contractor which includes employer's design team. This total litigious arrangement if not being properly monitored will produce arising numbers of contractual disputes and arbitration cases. Rights of contractors and design teams seemed not to be catered for in the novation agreement due to the bespoke agreement drafted in project to project basis by the employer's contract drafters. Protection to the interest of the contractor and consultant is to be attained. Therefore, the objective of this research is to identify the feasible contractual solutions to the implementation of novation agreement in design and build in order to suit the requirement and the intention of the employer and at the same time to ensure the impartiality of the rights and obligation of the contracting parties. The scope of this research is confined under the design and build system implemented in Malaysia and in UK. The methodology of this research adopts from literature review together with the conduction of semi-structure interviews with various construction professionals. As a conclusion with this research, the probable solutions shall be either the institution of the Malaysia standard form of novation agreement or warranty furnished by the design team on pre-novation breaches, supplementary agreement to the novation agreement or the change in the methodology where the contractor is allowed to step in earlier during the design stage.

ABSTRAK

Di dalam senario industri pembinaan di Malaysia pada masa ini, perkataan reka dan bina tidak mungkin lagi memerlukan terjemahan yang mendalam, memandangkan penglibatan sistem ini sejak dari tahun 1999. Walaubagaimanapun perkataan novasi di dalam konteks kontrak reka dan bina mungkin memerlukan terjemahan secara menyeluruh. Sistem ini merupakan sistem yang baru yang di implementasikan oleh salah satu pemaju terbesar di negara ini. Sistem ini telah memberikan kebaikan kepada pemaju yang juga merupakan klien dari segi operasi sistem tersebut dan ini telah menarik perhatian kebanyakan klien di negara ini dalam mengimplimentasikan sistem tersebut. Melalui sistem novasi dalam kontrak reka dan bina ini, klien dapat menglibatkan diri dalam proses rekaan secara menyeluruh sebelum tender di keluarkan dan selepas rekaan telah direalisasikan oleh konsultan maka klien akan membuat sistem novasi iaitu menyerahkan tanggungjawab klien ke atas konsultan kepada Kontraktor. Sistem ini boleh menyebabkan berlakunya permasalahan dari segi kontraktual dan pemakaian yang berluasa tanpa di bendung oleh mana mana pihak yang bertanggungjawab akan menyebabkan keadaan kontraktor dan konsultan tidak terbela. Oleh itu, objektif penyelidikan ini adalah untuk mengenal pasti penyelesaian yang mungkin ke atas implementasi sistem ini. Bagaimanakah pemgunaan sistem ini dapat diteruskan dengan memastikan kehendak klien dipenuhi dan pada masa yang sama hak, obligasi dan liabiliti kontraktor dan konsultan terjaga. Skop penyelidikan ini dihadkan kepada pemakaian kontrak reka dan bina di Malaysia dan juga di UK. Dari segi metodologi, temuduga dijalankan dengan professional yang menglibatkan diri didalam pemakaian sistem novasi ini. Sebagai kesimpulannya, penyelesaian yang mungkin dapat dicapai dalam permasalahan ialah diantaranya samada kita dapat mengeluarkan borang kontrak novasi di Malaysia atau pengeluaran waranti oleh konsultan kepada kontraktor atau juga suplementari kepada kontrak novasi atau penyelesaian terakhir iaitu penukaran metodologi sistem tersebut dimana penglibatan kontraktor pada peringkat awal rekaan.

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CHAPTER 1

INTRODUCTION

1.1 INTRODUCTION

In any type contracts generally, it contains both rights and obligations. Rights are known as 'benefits' and obligations are known as 'burdens'. The rights under the contract are the legal rights and in effect amount to the right to sue for any breach of contract. Rights under the contracts can be transferred by 'assignment' without the consent of the other party to the contract unless there is any prohibition stated against such assignment in the contract itself. Nevertheless, for obligations or burdens or liabilities under the contracts, the only way that it can be assigned is with the consent of the other contracting party. This is because the concept of the transfer the obligation is in a similar condition to the transfer of risk and any failure by the original party to perform the obligation under the contract will impulsively transfer the greater risk to the other novated party. Unless there is such an agreement, neither parties can rid themselves of any obligation which they owe to the other under the contract. This is commonly expressed in the proposition that the burden of a contract cannot be assigned, unilaterally.

Novation is a tripartite agreement by which an existing contract between party A and party B is discharged and a fresh contract is made between party C and party B, usually executed on the same terms as the first contract. Upon novation party B ceases to be liable to party A and party A discharges party B from any further performance. The liabilities that party B has accrued and from which party A would benefit prior to the novation are transferred to party C. Party C enjoys the benefit of those liabilities and is entitled to require the performance of the obligations that remains for party B to perform.

The following diagrams will explicitly show the transformation from the old contract to a new contract and the relation among the contracted parties.



Figure 1.1 Illustration of Contract executed between Party A and Party B before novation takes place

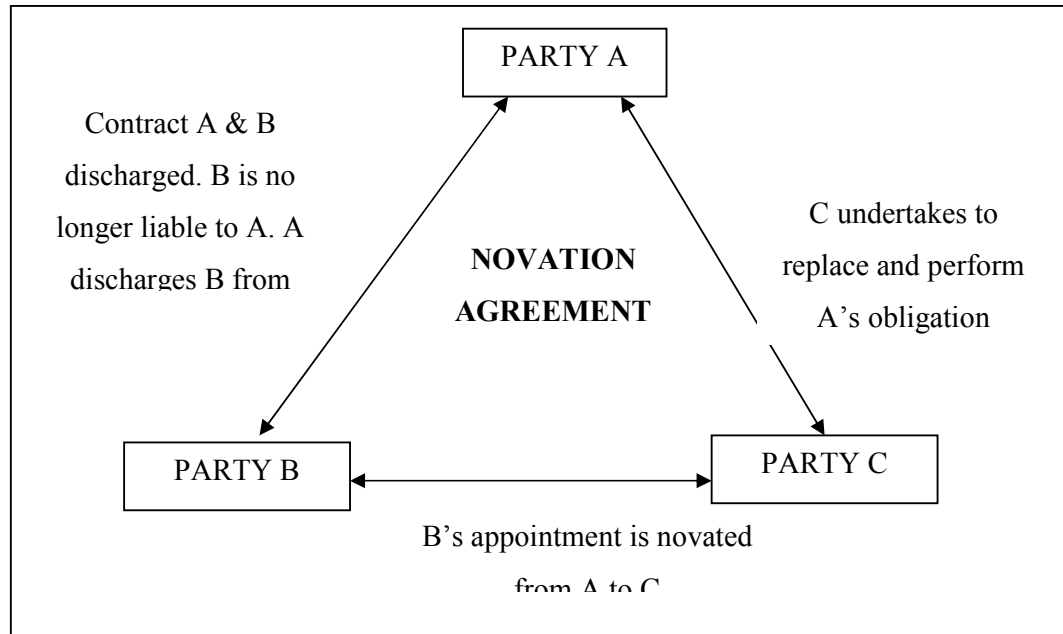


Figure 1.2 Novation Agreement between Party A, B and C

In the preceding years, novation was always intended for straightforward situations such as the payment of a debt, insolvency of a party, a corporate restructuring or some other circumstances. This sort of situation where novation in the classic sense may occur in the construction industry is where an employer transfers its interest in the project to another company in an arm's-length transaction.

In these circumstances one of the parties is simply substituted by another. This concept somehow is not implemented in Malaysia's construction industry under Design and Build procurement system.

Design and Build is now the fastest growing method of contract procurement, and Malaysia's construction industry is not excepted. It is in fact now a new flavour of the industry where both public and private client prefer to encompass the design and build procurement system toward their realization of project.

Nevertheless, a new ingredient has been added into the recipe. The employers are getting smarter in shifting the responsibility as much as he can to another contracted party. This is through the exercises of the novation agreement in the design and build contract. This generally is the process by which a contract between the employer and the consultant is transformed into a contract between the contractor and the consultant. It can only be achieved by agreement between all three of them, employer, consultant and contractor. If employer is entitled to look for the consultant for performance of the contract, he cannot be compelled to look to contractor for performance instead, unless there is a novation.

1.2 PROBLEM STATEMENT / ISSUES

As mentioned in 1.2 above, in the recent years, Design and Build procurement method has always been the flavour of the industry. However, these employers to their own advantages have attempted to have the best of both worlds by engaging their own consultants prior to the appointment of the design and build contractor. These consultants are then novated to the design and build contractor who accepts entire responsibility for the design including any design carried out by the consultants prior to their appointment.

The employer and the contractor have different interests in the development. The employer does not drop out of the picture as in the classic novation, but instead retains its interest in the project. This gives rise to a situation which has obvious differences from the classic novation.

The obligation of the consultant change, even if the novation does not expressly state this. The services the consultant would have performed for the employer will differ from those required by the contractor. The Consultancy Services between the employer and the consultant are in fact of the normal consultancy services as per the requirement of their respective Professional Bodies i.e IEM, PAM etc and there are none whatsoever at the current moment control by any bodies towards the execution of novation agreement.

1.2.1 Main Issue

As explained above, the novation agreement is not drafted under any condition and/or requirement or under any control by any professional bodies. It is infact is drafted under the requirement by the employer itself being the paymaster of the project. Various employers would generate various versions of novation agreement to their own interest.

The above event has formed the inconsistencies of terms and conditions imposed toward the novated parties especially the consultant and the contractor. Being the paymaster of the project, the employer will always have the best of everything. However, it raises an issue of impartiality and unilateral relation between the contracted parties.

If this is the case, will the contractor be covered if in the event there is a negligence by the consultant during the pre novation period that affects the tender exercise without the knowledge of the contractor and will the contractor be entitled for variation works with respect to the insufficient information provided during the tender as a results by the consultant's slackness.

Accordingly, there have been suggestions as to many contractual solutions to this issue. Research will be conducted through interviews with the relevant parties to this industry as to the probable or the most appropriate solution or remedy to the current dilemma of novation agreement in design and build. A peep as to how this scenario is dealt with and exercised in other country will also be incorporated in this report.

1.3 OBJECTIVES OF STUDY

To identify the feasible contractual solutions to the implementation of novation agreement in design and build in order to suit the requirement and the intention of the employer and at the same time to ensure the impartiality of the rights and obligation of the contracting parties.

1.4 SCOPE OF THE RESEARCH

The scope of this research will be confined to the following areas :

- (a) The implementation of Novation Agreement within the Malaysia's construction industry.
- (b) The implementation of Novation Agreement within the UK's construction industry.
- (c) Under Design and Build procurement system
- (d) Cases in relation to the novation agreement in design and build.

1.5 THE IMPORTANCE OF THE RESEARCH

In view of the fact that the implementation of the Novation Agreement in the Design and Build contract is indeed new to the Malaysia construction industry, it is with the intention that with this research, it will contribute to a very significant information and knowledge to the construction industry players.

The information contains herewith in this research will at least provides the introductory reports to what novation agreement in design and build is all about. This would help and/or suffice the industry players as to the rights, obligation, entitlements and risk that are to be looked for if in the event this method of the implementation is favoured and are to be realized in the future by most of the employers irrespective from public or private sector.

In any case, it will build the awareness and as a guidance to the appropriate measures or steps that is safe to be taken prior to the execution of the novation agreement so as to safeguard the interest of the novated parties.

1.6 RESEARCH METHOD

In achieving the research objective as stipulated above, a systematic research method has been established. Since this research is an explorative research therefore other than based on the literature review, a semi-structured interviews were conducted with all the people involved in this industry.

Sources for literature review are from books, journals, newspaper articles, lecturer notes and magazine. These sources are proven in providing a lot of reliable data that can help to show the path towards the journey in writing of this research. On the other hand, semi structured interviews were conducted with respondents that was first being selected based on their professionalism, experienced and hands on to the research topic and also people in the industry who are yet to be involved in order to get a reliable and practical response in a manner of comments, suggestion and on how the research should be organized and positioned.

Respondents shall be from the respective contracted parties to the novation agreement namely employers, consultants and contractors. Contract drafters such as lawyers were also part of the respondents. The sources of the respondent for the employers shall be confined to the organization implementing the novation agreement in their design and build contracts and as for the consultants and contractor, the sources shall be those who are in the situation who handling the projects using the novation system.

All these reading sources can be obtained at the internet sites that are related to this dissertation and library; Perpustakaan Sultanah Zanariah, UTM and Perpustakaan Tunku Abdul Razak, UiTM. Analysis of cases collected from Malayan Law Journal (MLJ).

The introduction stage of this research started with the general introduction of the design and build procurement system and novation agreement in general. In chapter 3, detail approach is made on how the arrangement of novation system towards the implementation of design and build contracts.

This will be followed by the analysis in chapter 4. Analysis will be focused directly in a manner from the comparison in the implementation of novation system between Malaysia construction industry and UK construction industry. Response from the relevant respondents also is made to know what is actually the impacts

towards the organization who involves in this exercise, this shall not limited in analyzing the advantages and the disadvantages which were the outcomes from the several projects conducted using this system.

Finally as in chapter 5, the conclusion will be presented.

1.7 ORGANISATION OF THE REPORT

This report comprised of five chapters of which the brief description of each chapter shall be as follows :

Chapter 1: Introduction

This chapter presents the overall content of the whole project writing. It introduces the subject matter, the problems that are purported to solve. The objective is specified with an appropriate research method to achieve them.

Chapter 2: Design and Build and Novation Agreement – The Modus Operandi

This chapter will enlighten the operation method for both design and build procuremen system and novation agreement in general. The purpose is to prepare the readers with the introductory information before reaching the detail in the following chapter.

Chapter 3: Novation Agreement in Design and Build Contracts

This chapter will further explain and supported with detail illustrations on how the operation mechanism of the design and build procurement system if the novation agreement is to be incorporated in. The discussion will includes on how the transfer of rights, obligation and the most significant factor which the liabilities from the employer to the contractor and the split performance by the consultant.

Chapter 4: Analysis of the Research

This chapter will analyse the data received from various literature sources and interviews. Comparisons will be made between the practice of novation system in Malaysia which is new and also the practice in UK which is already well established. Analysis also will be made through the opinions by the various respondents from the interviews conducted with the relevant respondent.

Chapter 5: Conclusions

This chapter presents the conclusions for the overall research.

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