

**REVISING CONTRACT SUM:
THE EMPLOYER RIGHT TO SET – OFF PAYMENT**

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*To my beloved Father and Mother,
Sister and Brother.*

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

Until today, dispute concerning payment had long plague the construction industry. Despite, on what was written on contract on agreed contract price, the employer always dissatisfied with contractor's work. This led the employer to reject payment issued by the Architect by withholding and later setting – off payment in interim certificate. This kind of action had caused the contractor to bring action against the employer in reclaiming the money due to them. On the other hand, the employer will counterclaim against the contractor by putting up excusable reasons in delaying payment. Set – off always misconstrued as same as counterclaim or abatement. In related cases, decisions decided by the judge put conditions in construing the terms. The research also concluded that defective works was the key factor of why the employer setting – off interim payment to the contractor. In this regard, the Court will depend solely on precedent cases available and the most prominently the provision of set – off available in contract. Hence, the employer right to set – off payment must be made according to contract available and not blindly done.

ABSTRAK

Sehingga hari ini, pertikaian mengenai bayaran telah lama menghantui industri pembinaan. Walaupun, telah nyata di dalam kontrak berkenaan persetujuan harga kontrak, majikan selalunya tidak berpuas hati dengan hasil kerja oleh kontraktor. Ini menyebabkan majikan menolak bayaran yang dikemukakan oleh Arkitek dengan cara menahan dan kemudiannya memotong bayaran di dalam perakuan interim. Tindakan sedemikian menyebabkan kontraktor membawa tindakan mahkamah bagi memperolehi semula bayaran yang masih terhutang. Sebaliknya, majikan akan mengemukakan tindakbalas terhadap permohonan kontraktor dengan mengemukakan pelbagai alasan dalam melewatkan pembayaran. “Set – off“ selalunya disalahtafsirkan sama sebagai “counterclaim“ atau “abatement“. Dalam kes – kes yang berkaitan, keputusan yang ditetapkan oleh hakim telah meletakkan syarat – syarat dalam mentafsirkan terma ini. Penyelidikan ini juga merumuskan bahawa kecacatan kerja merupakan faktor utama mengapa majikan memotong bayaran interim kepada kontraktor. Dalam hal ini, mahkamah akan bergantung sepenuhnya kepada keputusan kes – kes yang didapati

sebelumnya dan semestinya syarat - syarat pemotongan sememangnya terdapat di dalam kontrak. Oleh yang demikian, hak majikan di dalam memotong bayaran hendaklah dibuat berdasarkan syarat – syarat kontrak dan bukannya sewenang – wenangnya pemotongan dilakukan.

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CHAPTER 1

INTRODUCTION

1.1 Background of Study

Contract is a written document between two parties where both parties had agreed based on the concept of offer and acceptance. Consequently, consideration will be the significant point through the completion of the project. The contractor is expected to deliver the project entirely that fulfill the objectives set out according to employer's requirement. On the other hand, the employer function is basically to pay for the works in accordance with payment terms of the contract. The primary obligation upon the employer is to give the contractor the sum of money which forms the consideration for the contract. This idea known as Dawneys principle as emphasised by Lord Denning in

*Dawnay Ltd. v. FG Minter Ltd. and others*¹ case, whereby there should not be any interruption of cash flow in the building industry, which itself the lifeblood of the industry. Shared understanding of each responsibility is the key success of construction project. Because of dynamic risks in construction especially dealing with large capital and long period to complete, money itself is the motivation factor. Money must be paid promptly and fully unless there are specific reasons for withholding it.

Issue of payment has plagued the construction industry for a long time. Frequently, dispute concerns with the failure of the employer for non – payment, delaying payment and short payment to the contractor. This had contributed about 56.7% in profiling of payment disputes². That kind of hardship affects the current financial of the contractor which depends solely on interim certificate in continuing the project. According to New Straits Times news, the problem for non – payment or smaller payments by the main contractor has resulted delays and poor quality of works in many projects³. This had suggested the Works Ministry to make direct payment to sub – contractor in handling government projects⁴.

Responsibility of payment begins with the issuance of certificate. Accordingly, the certificate will frequently be held to be conclusive as to any matter of fact which it

¹ (1971) 2 All ER 1389

² Dr. Rosli Abdul Rashid et al. (2007). *Profiling the Construction Disputes for Strategic Construction Contract Management*. UTM. A seminar paper.

³ Comment by former Work Minister, Datuk Seri S. Samy Vellu. *Sub – contractors to be paid directly by Works Ministry*. NST, February 1 2006.

⁴ Ibid

certifies⁵. It does prevent one party from contesting what it certifies, even if the certificate is erroneous. In many cases, the court would construe it in strictly way⁶. The court will re – open the certificate only to show that the certificate was not conclusive even though there is an arbitration clause in agreement⁷.

The architect must act impartially in issuing any interim certificate by showing how much money owes. Thus, interim certificate in effect creates a debt due⁸. The significant point of concern lies with the contractor ‘that the quality of works executed, or any equipment, materials or goods are to be to the reasonable satisfaction of the SO’⁹. An interim certificate given under a contract will usually be final as between the parties to the contract, even if the certifier is mistaken or negligent. The employer has no right to amend any interim certificate aside from architect’s instruction¹⁰. Such action if taken was in fact violating the contract agreement which may bring contract determination by the contractor¹¹. Additionally, the issuance of interim certificate might prevent the employer to take an action against the contractor for negligent caused by defects that may present but not noticed such as patent defects or that may subsequently appear or latent defect. The employer tends to arbitrarily resist payment or delaying payment and also making counter claim because of over-valuation, applying set-offs/deduction or withholding payment even before Final Certificate was issued on merely trivial grounds;

⁵ Kim Lewison (1989). *The Interpretation of Contracts*. London at p 283.

⁶ *Kollerich @Cie S.A. v. State Trading Corporation of India (1979) 2 Lloyd’s Rep. 442*

⁷ *East Ham Corporation v. Bernard Sunley and Sons Ltd. (1966) AC 406*

⁸ *Pickering v. Ilfracombe Railway (1868) LR3 CP 235*

⁹ Clause 43.2(a)(i) (CIDB2000)

¹⁰ Hanim bt. Mohd. Yusoff (2001). *Peruntukan Set – Off Dalam Borang Kontrak Setara PAM98*. UTM. Undergraduate Project Report.

¹¹ Clause 26.1(i) (PAM98 or PAM2006)

thereby choking the financial lifeline of the contractor with dire consequences to the latter.

Damages for failure to complete a work were supposed to be originally recoverable by separate action but it may now be claimed by way of set – off or counter – claim, according to circumstances¹². Where the contract does not make completion a condition precedent to payment there may be an implied stipulation on the part of the employer to pay from time to time a reasonable sum to the contractor during the progress of the work¹³. Although the employer may have accepted the work so that a liability to pay the price of it arises, that does not prevent the employer from showing that the work is incomplete or badly done; he may either counter – claim or set – off damages in an action by the contractor, or he may pay or suffer judgment to be obtained against him for the full price and later bring a separate action for damages, or he may set up the defects in diminution of the price by way of defence to an action by the contractor and later bring a separate action for any special damage which he may suffer by reason of the breaches of contract¹⁴. The contractor on the other hand, may apply to court for summary judgment on the certified amount¹⁵.

¹² I.N. Duncan Wallace (1986). *Construction Contracts: Principle and Policies in Tort and Contract* at p 693.

¹³ *Roberts v. Havelock (1832) 3B. & Ad. 404*

¹⁴ *Davis v. Hedges (1871) LR 6 QB*

¹⁵ *Workman, Clark & Co. v. Lloyd Brazilleno (1908) 1 KB 968*

1.2 Problem Statement

Ang Su Sin (2006) in his study on *“Present Payment Issues – The Present Dilemmas of Malaysian Construction Industry”* mentioned that *“the construction industry is always in dispute prone. It is therefore common for the claimant pursuing his claim for works and services rendered to meet with a cross claim instead for defective work, delayed completion etc. So, payment is always postponed until the resolution of the dispute.”*

Despite of what was required by the contract that the contractor needs to perform as ‘regularly and diligently’, the employer seems to express dissatisfaction of work done. Because of this, the employer tends to reject certificate issued by the architect that considered as ‘overvaluation’. Consequently, the employer will likely to apply set – off as counterclaim. At common law, set-off is a direct and logical remedy immediately available and often understood under various labels, such as apportionment, abatement, counterbalance, counterclaims or cross-claims. Such undervalue of certification put dilemma to the unpaid contractor due to his cash flow and profitability are in jeopardy.

1.3 Objective of the Research

The objective of this research is to find out the Malaysian court stands in relation to set-off payment in construction contract. This will determine the factors that cause the

employer to withhold and later on set - off payment in the preparation of Final Account and consequently affect the new Contract Sum in the end.

1.4 Scope and Limitation

This research aims to focus and examine local construction cases. The scopes of this study are as follows:

- i. This research is confined to the main party in privity to the standard form of contract; which is the main contractor, the subcontractor, the supplier and the employer.
- ii. The focus of standard form is confined between PAM, JKR and CIDB. However, for the purpose of discussion, any standard form which available in local cases will be referred.
- iii. The focus of payment certificates begin from initial interim certificate until the Penultimate certificate.

1.5 Previous Research

The first was prepared by Tan EE Len called *The Conclusiveness of Final Certificate as a* dissertation of Master's project report. The objective of the study is to

identify circumstances which determine whether the Final Certificate is legally binding upon the parties and conclusive to what it certifies.

The second was done by Tan Pei Ling called *Employer's Rights and Contractor's Liabilities in Relation to Construction Defects after Final Certificate* as a dissertation of Master's project report. The objective of the study is to identify the legal position of the construction contract parties in relation to employer's rights and contractor's liabilities in defects after the issuance of Final Certificate.

Previous researches had studied on the issuance of Final Interim Certificate and its effect in which last payment of Contract Sum is said to be warranted and conclusive. Hence, the period before the issuance of Final Certificate wasn't touched at all. In filling the gap, this study is taking a different approach where payment towards finalising Contract Sum was still progressing until the issuance of Penultimate Certificate.

1.6 Methodology

Basically, this research will adopt five steps as its methodology and research process in order to achieve its objective. The steps are discussed further as follows:

Step 1: Identification of Research Topic

This is to give a thorough understanding of what this research is all about with some initial definition of the topic under study.

Step 2: Research Objective

This is the determining of what the research is opting to achieve in studying the factors and related issues in disputing the finalising of Final Account.

Step 3: Data Collection

This is the gathering and consuming the medium of literatures as stated in the Scope of Research above. The medium of literatures will be based on secondary data as shown in Figure 1.0 below.

Step 4: **Analysis**

This will be the main text of this Masters Project paper which is analysing and commenting the application of set-off or withhold payment towards finalising the contract sum whether this actions are lawful or unlawful through the legal point of view from the examples of judgment held in law cases and written it systematically into chapters in this Masters Project paper.

Step 5: **Conclusion and Recommendation**

This step will conclude and summarise the whole of the Masters Project paper, the outcome of objective achievable as well as making some recommendation to the outcomes. This Masters Project paper will also identify factors that cause the employer to set – off payment that would help reader to have better clear understanding the issues surrounding it.

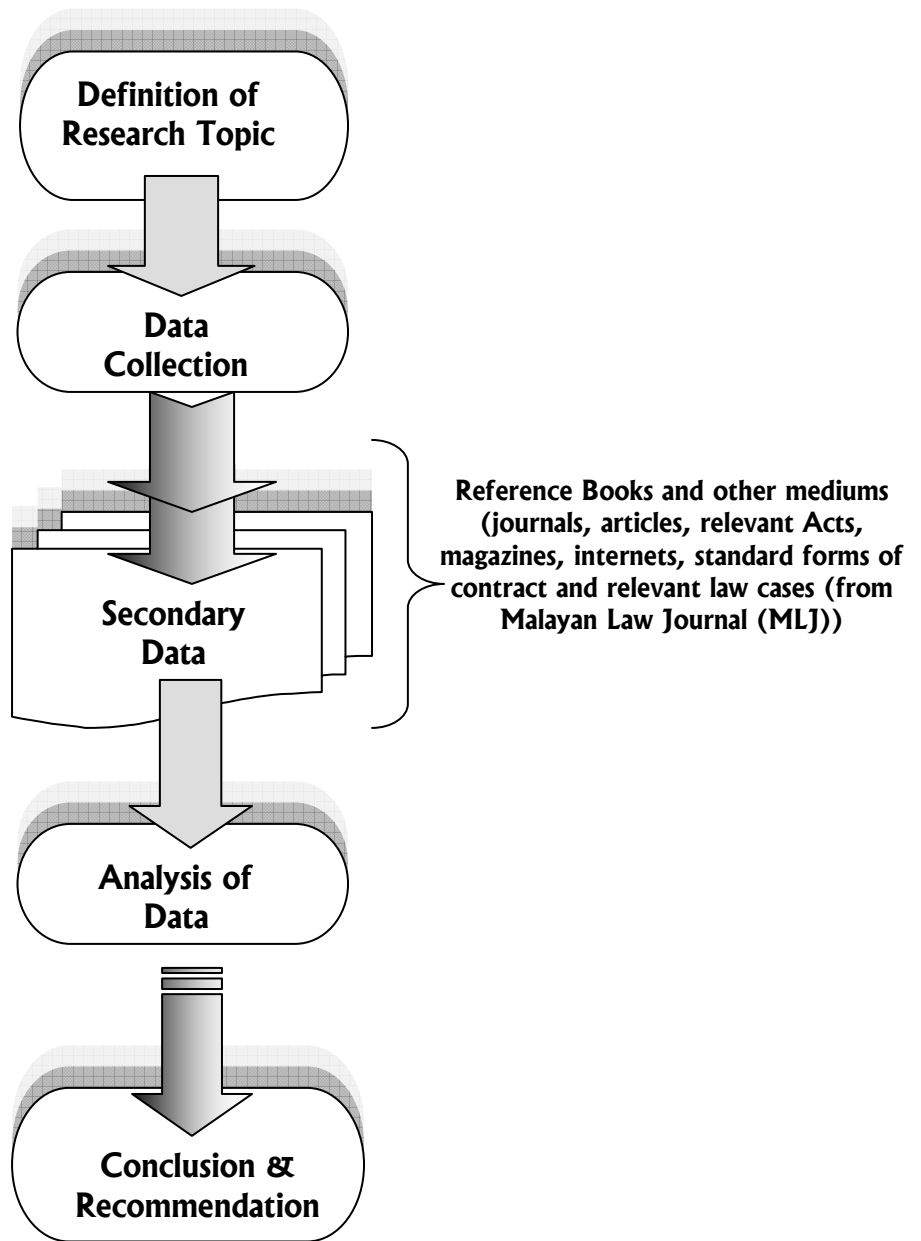


Figure 1.0: Research Methodology Flowchart

1.7 Chapter Organisation

In addressing towards the objective of this research, the following chapters will be planned as follows:

Chapter 1: Introduction

The introduction is the first chapter consists of the overview of this Masters Project paper as well as stating the aim and objectives, issue or problem statement, scope and methodology of study, previously similar research, and brief description of chapter organisation.

Chapter 2: Introduction to Final Account

The second chapter is basically the brief information on the concept payment through interim certificate, contract sum association with Penultimate Certificate and Final Certificate and also related cases in managing payment in construction contract.

Chapter 3: Set – off and Withhold of Payment

This chapter basically discusses the theory and distinction between set – off, counterclaim and abatement according to relevant cases. This chapter also looks at the provision of set – off which available in PAM, JKR and

CIDB and also in Limitation Act 1953. This will determine the right of the employer to set-off or withhold payment which available in contract.

Chapter 4: Circumstances that Allow Employer to Set – Off Amount in Contract Sum

This chapter is the core of the research and basically deals with the detail legal issues surrounding the relevant cases ranging from English cases and Malaysian cases. From analysis done on all applicable cases, factors of employer in disputing the amount in interim certificate will be determined.

Chapter 5: Conclusion

Lastly, chapter five will conclude and summarise the whole of the paper, the outcome of objective achievable as well as making some recommendation to the outcomes leading to better awareness in the entire supervision in construction cost management. This will add as additional references for students and practitioners in the Malaysian Construction Industry especially in the context of Construction Contract Management.

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