MahWengKwai & Associates

ADVOCATES AND SOLICITORS

Speaker
CHRISTINE TOH
Partner

Moderator
HANNAH PATRICK
Senior Associate

Wed 13 Jan 2021
3:00pm (GMT +8)

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MWKA ONLINE TALKS

Retention Sums in Construction Contracts: Rights and Remedies

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About Us

- Welcome to MahWengKwai & Associates!
- Trusted by small medium enterprises (SMEs), family businesses and individuals.
- Established in 1985 by Dato' Mah Weng Kwai, now a consultant with the firm.
- Medium-sized law firm with 22 lawyers and 19 staff.

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Our Services

- Full-service law firm with 4 Departments:
  - Corporate
  - Dispute Resolution
  - Employment
  - Individuals & Families

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Our Practice Groups

- 5 Practice Groups:
  - ASEAN-China Desk
  - Construction
  - Foreign Direct Investment
  - Real Estate
  - Sports & eSports

MWKA Online Talks

- To share knowledge, raise awareness, encourage networking
- For clients, potential clients, in-house counsel
- Recent MWKA Online Talk:
  - 16.12.2020: Breach of Contract, The COVID-19 Aftermath
- Upcoming MWKA Online Talk:
  - 10.2.2021: Cybersecurity Laws in Malaysia

Christine Toh

- Partner in Dispute Resolution department in MahWengKwai & Associates
- A member of Association of Chartered Certified Accountants, certified Adjudicator and empanelled with the Asian International Arbitration Centre
- Areas of practice include construction adjudication, arbitration & litigation, taxation, family law and contractual disputes.

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Most liked / popular questions will be discussed and answered by the speaker(s) during the Q&A session.

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Talk Points

- How retentions sums are supposed to work in construction contracts
- Options available when the employer refuses to release retention sums
- How to claim for retention sums if the employer has been wound up
- Impact of the COVID Act on claims for the release of retention sums

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Retention Sums in Construction Contracts

Retention Sums: Definition

- A sum retained by an employer against interim sums payable to the contractors for work done
- Released to the contractor at a later stage upon fulfillment of certain conditions
- The method of release depends on the terms and conditions of the construction contracts.
- MWKA Article: FAQ on Retention Sum In Construction Contracts

Retention Sums: Purpose

- Form of security to the employer for due performance of the construction contract by the contractor
- Ensure contractor properly completes the works required of them under the contract.

How is the Retention Sum calculated?

- Calculation of retention sum is usually encapsulated in the construction contract
- Depends on the terms and conditions of the construction contract
- In Malaysia, it is common for employer to retain 10% of the certified sum in its interim progress certificate
- Common practice allows a limit of retention sum of 5% of the total contract sum.

Release of Retention Sums

- Released in 2 tranches:
  - 1st portion will be released upon the issuance of the Certificate of Practical Completion ("**CPC**")
  - 2nd portion will be released upon issuance of Certificate of Making Good Defects ("**CMGD**").

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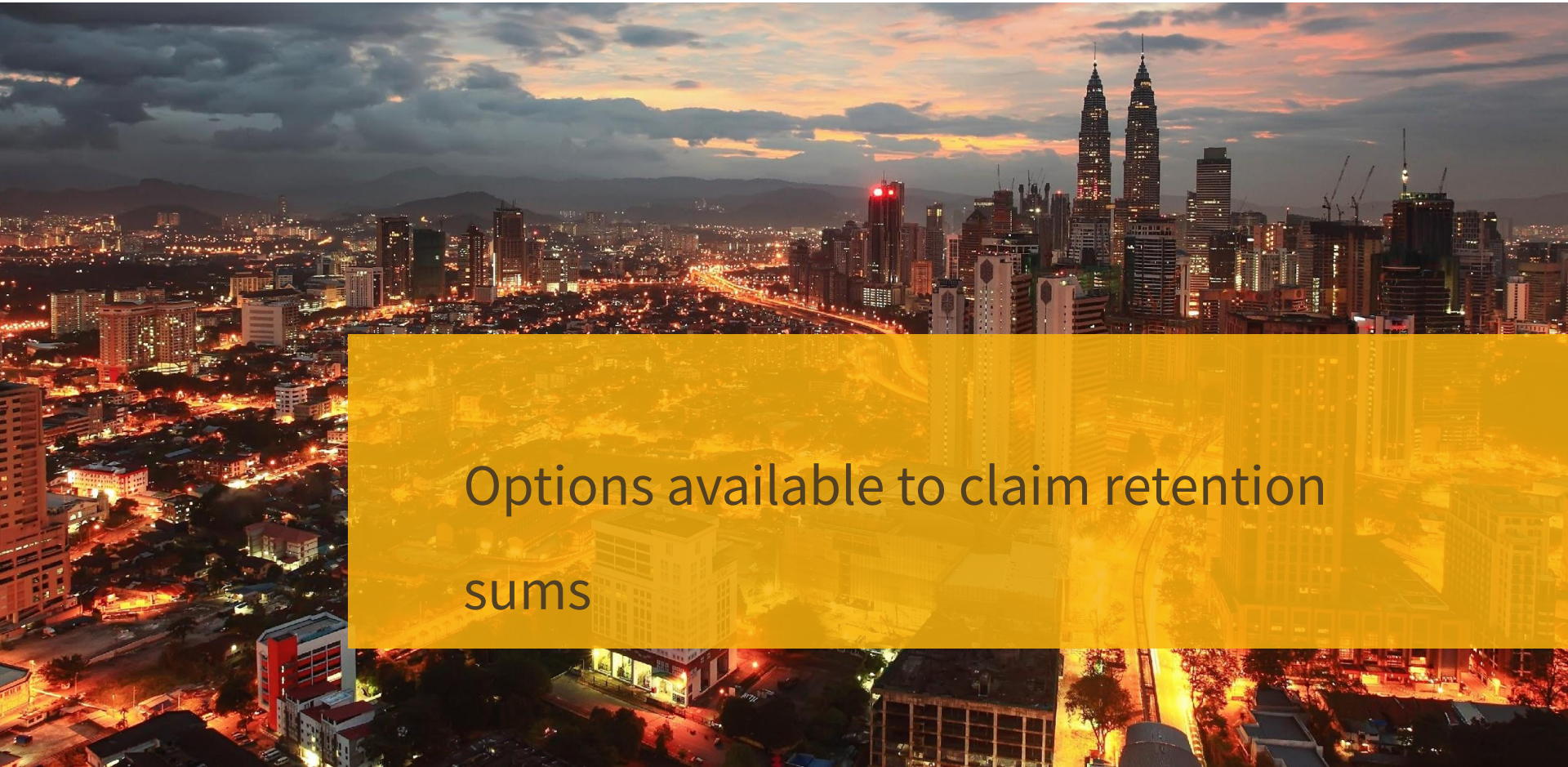

Options available to claim retention sums

Legal Recourse Available

- What if employers refused to release retention sum?
- Depending on the dispute resolution clause, the options available against the employer or main contract are as follows:
    - Adjudication Claim (Contracts fall within definition of construction contract under Section 4 of the Construction Industry Payment and Adjudication Act 2012 (“CIPAA”)
    - Arbitration
    - Court proceedings

CIPAA Proceedings

- A statutory right under CIPAA
- CIPAA applies to every construction contract made in writing relating to construction work carried out wholly or partly within the territory of Malaysia including a construction contract entered into by the Government.
- Not necessary for a construction contract to make any reference to CIPAA
- Unlike arbitration, there is no necessity to a specific adjudication clause in a construction contract

CIPAA Proceedings

- A claim for the release of retention sums is a matter under the purview of CIPAA
- ***Terminal Perintis Sdn Bhd v Tan Ngee Hong Construction Sdn Bhd and another case*** **[2017] MLJU 242**

    - [33] I agree with the Claimant that the **retention sum is the value of work done under the construction contract**, save that a percentage of the total value of work was retained under the express provisions of the Contract. The fact that the Employer may retain these amounts does not change the character of what is being claimed, i.e. **the value of work done as certified under the certification provision**

CIPAA Proceedings

- Non-issuance of CPC or CMGD is not a bar to the contractor's claim for the release of retention sums.

- Section 25(n) CIPAA, Adjudicator is empowered "*to decide or declare on any matter notwithstanding no certificate has been issued in respect of the matter*."

- ***Ritma Hebat Sdn Bhd v Kayangan Kemas Sdn Bhd and another suit* [2017] MLJU 2034 -** Para 70 & 71

Arbitration

- Arbitration Act 2005
  - This Act allows the parties to resolve disputes through arbitration
  - Enforceable and recognized as a judgment of High Court
- Section 9 of the Act
  - In this Act, arbitration agreement means an agreement by the parties **to submit to arbitration** all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not.

Arbitration

- Only if parties expressly agreed in a contract to resolve disputes through arbitration
- Section 10 of the Act
    - A court before which proceedings are brought in respect of a matter which is the subject of an arbitration agreement **shall**, where a party makes an application before taking any other steps in the proceedings, **stay those proceedings** and refer the parties to arbitration unless the agreement is null and void, inoperative or incapable of being performed.

Court Proceedings

- Proceedings in the Court
- Depends on the disputed sums
  - Magistrate Court - Below RM100,000
  - Sessions Court - Below RM1,000,000
  - High Court - Above RM1,000,000
    - Construction Court in Kuala Lumpur - Lim Chong Fong J & Hajah Aliza binti Sulaiman J
    - Construction Court in Shah Alam - Wong Kian Kheong J

Enforcement of Judgment - Garnishee

Proceedings

- Can retention sums be garnished?
- ***Binamin MJC Quarry Sdn Bhd v Way Soon Construction Sdn Bhd (Enclosure 26)*** **[2001] MLJU 111**
    - Retention sum is not debt due and accruing from the judgment debtor to the judgment creditor
    - Time would be a factor on the outcome of the retention sum
    - Affirmed by Federal Court in ***Malaysian International Trading Corp Sdn Bhd v RHB Bank Bhd*** **[2016] 2 MLJ 457**
    - Test: At the time when Garnishee order was granted, was there an actionable debt pending?

Enforcement of Judgment - Garnishee

Proceedings

- Can retention sums be garnished? (cont'd)
- Comments:
    - Time is of factor. Depends on when Court action was taken/judgment was registered
    - Was the CPC or CMGD already issued?
    - If yes, then can argue that debt is due and payable
    - Refer Clauses 30.6(c) and 30.6(d) of PAM 2018 for timing of release of monies

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Claims against Wound Up Employers

Legal Recourse - Employer is wound up

- What happens to the contractors' rights when the employer holding trust monies are wound up?
- Depends on whether retention sums are trust monies set aside by the employer, in a separate account.
- Limitation period to bring a claim in civil courts is 6 years from the date of accrual of the cause of action

Employer is wound up - Set-Aside As Trust Monies

- Retention sum set aside as trust monies
  - retention sums will not form part of the employer's assets
  - not to be used for debt repayment
  - trust monies held by employer in trust
  - winding-up does not alter the position of the contractors who are ultimate beneficiaries of the retention sums
- Contractor's claim takes priority where the employer's liquidator is duty-bound to hand over the trust monies to the contractors

Employer is wound up - Unsecured

Creditors

- Retention Sums retained by the Employer amounts to an unsecured debts to the Contractor
- Contractors claim as an unsecured creditor
  - File a Proof of Debt against employer
  - Appointed liquidator will make a determination on whether to admit the debt.
- However, admission of debt by the liquidator does not guarantee that payment will be made.
- Contractor become last in the list to be paid after debts of the secured creditors have been discharged

Federal Court in *SK M&E Bersekutu Sdn Bhd*

- ***SK M&E Bersekutu Sdn Bhd v Pembinaan Legenda Unggul Sdn Bhd (in creditors' voluntary liquidation) and Another appeal* [2019] 3 MLJ 281**
- Whether a retention sum not set aside amounts to trust monies?
- 2 Appeals heard together - Appeal No. 130 and Appeal No.131
- Actions by 2 subcontractors against a wound up contractor
  - Mixed development in Sungai Buloh for RM9.7m
  - Project in JB for RM17.7m
- Appeal No.130 - Retention sum owing was RM489k
- Appeal No.131 - Retention sum owing was RM887k

Federal Court in *SK M&E Bersekutu Sdn Bhd*

- Based on the terms of the subcontracts, the retention sums were to be released in 2 tranches
  - Upon issuance of CPC of the main contract
  - Upon expiry of DLP/ upon the issuance of CMGD
- A special resolution was passed for the voluntary winding up of the contractor
- Based on the statement of affairs, RM8.2m of retention sum was owing to 128 subcontractors

Federal Court in *SK M&E Bersekutu Sdn Bhd*

- Subcontractors commenced an action in the High Court asking for:
  - Leave to commence legal proceedings against the contractor
  - The contractor to preserve the retention sums in a separate account pending the final determination of the arbitration/adjudication proceedings
- High Court granted the order

Federal Court in *SK M&E Bersekutu Sdn Bhd*

(Cont'd)

- On appeal to the Court of Appeal, the High Court Order was reversed
- No trust because the lack of an express clause or clear conduct from the parties as well as the retention monies were never segregated
- Trust cannot be implied purely from the nature and purpose of retention sum *per se*

Federal Court in *SK M&E Bersekutu Sdn Bhd*

(Cont'd)

- The appeal to the Federal Court was dismissed, Court of Appeal decision was affirmed
- The Retention sums must be segregated into a separate account by the employer before insolvency
- Contractual obligation to hold retention sums does not automatically render retention sums as trust monies
- Contractor would not be able to rely on contractual terms if employer failed to segregate the retention sum.

Federal Court in *SK M&E Bersekutu Sdn Bhd*

(Cont'd)

- Subcontractors being exposed to high risk in the event the employers going into liquidation
- Reform proposed at paragraph 45 to 47 of the judgment

PAM Standard Form Contracts

- **PAM Standard Contract form**
- Clause 30.6(a) of both PAM 2006 and 2018 states:

  "*the Employer's interest in any amount so retained* ***shall be fiduciary as trustee*** *for the Contractor, Nominated Sub-Contractors and Nominated Suppliers…*"

- The clause above gives the employer an obligation to segregate the retention sum into a separate account
- If employer refuses, contractor may apply for a mandatory injunction to force the employer to do so [practicality?]
- See paragraph 27 & 28 of ***SK M&E Bersekutu Sdn Bhd***

AIAC Standard Form

- **AIAC Standard Form of Building Contract**
- Clause 30.6(a) similar to PAM
- However, Clause 30.6(c) states:

> *"For the avoidance of doubts, the duty of the Employer to **hold the Retention Fund as trust monies** shall remain irrespective of whether or not the Retention Fund has been paid into a separate trust account before its release, and the Retention Fund shall at all times **remain as trust monies** even after the Employer has gone into liquidation or bankruptcy and shall not form part of the general funds upon liquidation or bankruptcy of the Employer"*

AIAC Standard Form

- Comments:
  - Read Clause 30.6(c) in light of ***SK M&E Bersekutu Sdn Bhd***
  - While it may be argued that parties have clearly **agreed** that the retention monies are to be regarded as trust monies irrespective of the failure to segregate this sum, it remains that no trust fund is established
  - FC appears to agree with the CA's reasoning - Refer to para 14, 35 & 36

Last Verdict?

- At the inception of the contract, parties may suggest to open an escrow account to deposit the retention sum monies

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COVID-19 Act 2020

COVID Act 2020

- The Temporary Measures for Reducing the Impact of Coronavirus Disease (COVID-19) Act 2020 ("COVID Act 2020")
- Came into effect on 23 October 2020
- Date of commencement and period of operation depends on the respective Parts in this Act
- Continue to remain in operation for a period of two years from the date of publication.
- Can be extended by the Prime Minister

Update on the COVID Act 2020

- Extended by way of the Temporary Measure for Reducing the Impact of Coronavirus Disease 2019 (COVID-19) (Extension of Operation) Order 2020
    - Part II of the Act has been extended from 1.1.2021 to 31.3.2021
- Temporary Temporary Measure for Reducing the Impact of Coronavirus Disease 2019 (COVID-19) (Amendment of Schedule) Order 2020
    - Schedule of the Act has been amended to include 2 additional categories of contracts under Section 7 of the Act

Section 7 - Reliefs

- **Section 7 - Inability to Perform Contractual Obligation**

  "*The inability of any party or parties to perform any contractual obligation arising from any of the categories of* ***contracts specified in the Schedule*** *to this Part due to the measures prescribed, made or taken* ***under the Prevention and Control of Infectious Diseases Act 1988*** *[Act 342] to control or prevent the spread of COVID-19* ***shall not*** *give rise to the other party or parties exercising his or their rights under the contract."*

- **Schedule to Section 7 - List of Categories of Contract**
  - Item 1 on the List - Construction work contract or construction consultancy contract and any other contract related to the supply of construction material, equipment or workers in connection with a construction contract

Inability to Release Retention Sums?

- **Can the Employer argues that its inability to release retention sum is protected under Section 7 of the COVID Act 2020?**
    - Appears that construction contracts fall within the ambit of the Section 7
    - However, the employer will have to prove that the inability to release the retention sums is due to measures prescribed, made or taken under the Prevention and Control of Infectious Diseases Act 1988 [Act 342] to control or prevent the spread of COVID-19

Questions?

Upcoming Talks

Date	Topic	Speaker
10.2.2021	Cybersecurity Laws in Malaysia	Lesley Lim

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Thank you!

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