

RELEVANCY OF MODEL TERMS OF CONSTRUCTION CONTRACT FOR SUBCONTRACT WORK

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ABSTRACT

In Malaysia, there is no standardized form or terms for domestic subcontract. A domestic subcontract is procured directly by the main contractor to carry out part of the work for which the main contractor has undertaken under the main contract. In this case, the need for subcontracting, the terms of the subcontract and the choice of a subcontractor are left to the commercial discretion of the main contractor. Problems arising from the usage of non-standard form are getting more serious. In 2007, the Malaysian Construction Industry Development Board (CIDB) entrusted with the responsibility to address pertinent issues and problems faced by the industry drafted and issued the Model Terms of Construction Contract for Subcontract Work. Based from the literature based research and qualitative method, it was found that payment is the highest major contribution to the critical subcontracting issues and problems faced when using non-standard form. Apart from that, based from the case analysis, Model Terms have the ability to minimize the problems faced when using non-standard form.

Keywords:

Model Terms of Construction Contract, Subcontract, Subcontractors, Standardized Form, Payment Issues.

INTRODUCTION

In Malaysia, like in many other countries, many construction works are subcontracted. CIDB (2007) stated whilst there are various standardized contracts for main contracts and the corresponding ‘nominated’ subcontracts, there are no published standardized forms or terms of contract for ‘domestic’ subcontract works in Malaysia.

Records from CIDB (2007) indicated that over the last five years, an average of 5,000 main contracts exceeding RM500,000 each are entered into each year. It is a common practice in the construction industry that for each main contract awarded; various subcontracts are let out to domestic subcontractors. Uff (1999) mentioned domestic subcontractors are selected by the contractors to do all the small construction works usually the outdoor work such as entrance road, fencing, pipe works etc.

As a result, many subcontracts are entered into based on various in-house contracts drafted by the main contractors. A significant numbers are let out on an ad-hoc basis and often incomplete in addition to many being let out entirely verbally. Problems arising from the usage of non-standard form are getting more serious. Construction Industry Development Board Malaysia (CIDB) entrusted with the responsibility to address pertinent issues and problems faced by the industry drafted and issued the Model Terms of Construction Contract for Subcontract Work 2007 on September 13, 2006.

The study looked into the relevancy of Model Terms of Construction Contract for Subcontract Work. The study determined the critical issues of subcontracting in construction projects and identifying the problems faced by main contractor and domestic subcontractor when

using non-standard form. Finally the study identified whether Model Terms could minimize the problems.

NATURE OF SUBCONTRACTING

The subcontracting system is usually described as the contracting process in which a main contractor subcontracts part of the job to another contractor, who may also subcontract to another firm or further subcontract as mentioned by Chiang (2009).

Subcontractors play a vital role when they are hired to perform specific tasks in a project. Shimizu & Cardoso (2002) agreed that subcontractors are specialist agents in the execution of a specific job, supplying manpower, besides materials, equipment, tools or designs. The larger and more complex the project, the larger will be the demand for subcontracting. To raise awareness within the industry about subcontracting, the parties involved must understand the nature of subcontracting first before they start to carry out the work efficiently.

CONTRACTUAL ISSUES IN SUBCONTRACTING

Payment Issue

A survey was conducted by MBAM (2005), among its members who comprised of contractors and sub-contractors. It was about 80.3% indicated that they had encountered slow progress payment. The respondents who encountered difficulties in getting progress payment were involved equally in public and private sector's projects. The survey also showed that the contractors are facing delays of payment for more than 91 days and up to 12 months compared to the contractual date.

Forty four percent of the contractors reported that they had encountered late payment situations in government funded projects while 53.5% had experienced late payment in private funded project CIDB (2006).

Retainage Withheld by Main Contractor

Sears & Clough (1994) stated that retainage can produce cash flow problems for contractors and subcontractors, resulting in substantial borrowing at a sometimes hefty interest rate, which results in higher construction costs for owners. In a study conducted by Hinze (2006), more than a third of the subcontractors surveyed stated that on periodic payments, the retainage withheld from their payments was equal to that withheld by the owner from the general contractor.

Incorporation by Terms

Where terms are not expressly stated in the articles of agreement or in an accepted offer, they may be incorporated by reference to other documents. In construction subcontract, the most common documents implied into a subcontract by reference will be a standard form of subcontract terms and conditions, either an industry standard or a form bespoke to the contractor, and / or by reference to the terms and condition of the main contract (McGuinness, 2007).

STANDARD FORM OF CONTRACT

The use of standardized forms of contracts has been generally considered practical and economical in the construction industry (Rashdi & Sutrisna, 2010). In many transactions, contracts are no longer negotiated between the parties as more and more contracts are entered into in standard form contracts where the terms of the contract are already printed on these documents (Sinnadurai, 2003). So, it indicates that the usage of standard form was globally used around the world in many businesses.

Pathmavathy (2005) summarized that the standard form of construction contracts provides a basic legal framework identifying the right, obligations and duties of the parties; establish the ambit of the powers and duties of the contract administrator.

Therefore, standard form generates many benefits as covers of terms of contract in agreement, established clear meaning, familiarity and the most important it provides roles and obligations of each party.

PURPOSED STANDARD FORM OF CONTRACT

The Objectives of Standard Form of Contract as mentioned by Harbans (2001) are:

- a) To provide the basic legal framework evidencing the legal relationship between the parties.
- b) To furnish a mechanism for regulating the conduct of the commercial relationship between the parties.
- c) To put in place the administrative procedures necessary to affect the legal and commercial relationship between the parties for achieving the purposes of the contract.
- d) To establish the ambit of the powers and duties of the contract administrators under the contract between the parties.

The use of standard forms of contract intends to ensure that all parties are familiar with the terms as a result of common usage that reduces the likelihood of disputes arising over the interpretation of the clauses. The parties are then aware of their rights and obligations under the terms of the contracts that are well documented.

NON-STANDARD FORM OF CONTRACT

Nonstandard form of contract is also known as bespoke contract. Standard forms generally adopt a balanced risk between the parties, however bespoke contracts often favour the owner or person drafting the contract. McGuinness (2004) found out that one-off or bespoke contract gives high expectancy of disputes.

Mills (2010) mentioned that bespoke forms of contract are not to be recommended. They create doubt and uncertainty in the minds of the contracting parties, and prevent those operating the procedures for drawing upon previous experience. This leads to uncertainty, inefficiency and misunderstanding. They often lead to extensive qualifications and negotiation and, by their very nature, are untested in court.

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THE CICC MODEL TERMS OF CONSTRUCTION CONTRACT FOR CONSTRUCTION WORKS

The CICC Model Terms of Construction Contracts for Subcontract Work, CIDB (2007) adopts plain language throughout, has no multiple cross-referencing, and is drafted in gender-neutral style. Ali (2008) stated that the CICC Model Terms had / has an average of 19 words per sentence. One notable feature is the unique structure of the contract which clusters the entire contract under 7 broad main clauses: (1) general obligations, (2) administration and changes to the work, (3) time obligations, (4) payment, (5) quality, safety, health, and environmental obligations, (6) legal rights and termination, and (7) disagreement and resolution of disagreement. This logical structure is intuitive to those familiar with the 3 tenets of project management – time, cost, and quality, and makes the contract relatively easy to navigate despite it being a relatively new contract. These broad main clauses and the sub-numbered clauses are set out in the contents pages of the contract (CIDB, 2007).

CHARACTERISTICS OF MODEL TERMS

The model terms are drafted entirely in modern plain language, adopts a project management approach and it had endorsement of 14 professional and trade organizations in Malaysia.

According to Ali (2007) there are some key characteristics of Model Terms, which are:

- a) Modern plain English.
- b) Structure – project management approach. Terms grouped by issues on time, cost and quality.
- c) Generic terms – usable with all main contracts.
- d) Stand-alone – not ‘back-to back’. But conversion to back-to-back is made easily possible using the appendix.
- e) No deeming provisions – and no ‘legal fiction’ (e.g. dogs are deemed to be cats or minor defective works are deemed not to be defective works).

By having all the characteristics above, it specifies that Model Terms are flexible enough to be used easily anywhere around the world with minimal or no modifications.

RESEARCH METHODOLOGY

The research methodology proposed to be employed in this research consists of:

Literature Review and Literature- Based Research

A literature review was carried out to gather and establish some sound knowledge of the research. Researchers typically look at the literature, prior to scheduling the particulars of a study, to discover what has been printed concerning a subject they are attracted in investigating. Attention is given to both the view of experts in the field and other research studies (Mahmud, 2009). The literature part of this study that gives a thorough understanding what is this research is all about in order to achieve one of the objectives which to determine critical issues of subcontracting in construction projects. This is done by exploring the current and past research on the subject-matter locally and internationally through journals, books, conference proceedings, internet and standard forms of contract.

Qualitative Method

Qualitative research involves the studied use and collection of a variety of empirical materials such as a case study, personal experience, introspective, life story, interview, observational, historical and visual texts that describe routine and problematic moments and meanings in people's lives (Denzin & Lincorn, 1994; Thomas, 2003). Zulhabri (2006) and Holmes et al. (2005), pointed out that the qualitative research was used if the researcher wants to understand a phenomenon about which he knows very little about, or when he does not have a complete knowledge of a particular entity. Therefore, for this research, in order to have more detail information on the area of a particular entity, the legal research was used as an instrument for qualitative data collection for all objectives.

By using the words 'subcontract', 328 cases from the judgment date as reported by the Malayan Law Journal were analysed. The cases were subjected to screening. At the first screening, the 242 cases were from the year 1996 until 2011. From second reading and screening, the court of 165 cases did hold cases in the construction industry. Further third screening only 61 cases were selected. For the first objective, 51 cases have been analysed. The cases were located under the terms of subcontract which are payment, performance bond, delay, arbitration, termination, variation and also damages. The gist of subcontracting issue from every case was highlighted and tabulated while another 10 cases have been analysed for the second objective. The same cases were used to achieve the last objective. The difference in the number of cases between objective 1 and objective 2 was due to lack of cases related to non-standard form.

Findings & Discussion: Critical Issues of Subcontracting In Construction Projects

There were 51 number of cases identified. The percentages of each are shown in the Table 1.0 below.

Table 1.0 Percentages of Case Analysis For Critical of Subcontracting Issues

Critical subcontracting issues	No of cases	Percentage (%)
Payment	17	33.3
Damages	8	15.7
Termination	6	11.8
Variation	6	11.8
Arbitration	6	11.8
Delay	5	9.8
Performance Bond	3	5.8
TOTAL	51	100

As illustrated in Table 5, it was found that 33.30% of critical subcontracting issues are payment. This is followed by damages, 15.7%, termination, variation and arbitration, each 11.8%, respectively; delay 5% and performance bond 5.8%. The results indicated and confirmed that the most critical issue in subcontracting was a payment problem. Not fully paid by amount certified

/ claim for outstanding payment and non-payment affecting the entire delivery chain. It is believed that the consequences of subcontractors being not fully paid and non-payment is grave, caused financial hardship to them.

From the finding, subcontractors are normally the financially weakest participant in the project. It is clear that the greater the percentage of subcontracted work, the greater would be the tendency of payment disputes.

Similarly, this finding is in line with research conducted by Master Builders Association Malaysia (2005) and Construction Industry Development Board (2006). They reported construction parties, namely subcontractors and main contractors had encountered payment problems for both public and private sector's projects.

Problems Faced By Main Contractors and Subcontractors When Using Non Standard Form

Table 2.0: Summary of the Cases Analysed

No	Cases	Problems	Judgment Priority to:
PAYMENT			
1.0	Mahkota Technologies Sdn Bhd (formerly known as the General Electric Co (M) Sdn Bhd) v Bs Civil Engineering Sdn Bhd [2000] 6 MLJ 505	No intention to exclude the right to set off in the contract	Main Contractor
2.0	Antara Elektrik Sdn Bhd v Bell & Order Bhd [2002] 3 MLJ 321	A dispute regarding term of payment when various form applied.	Subcontractor
3.0	Casmet Sdn Bhd v Unipac Engineering (M) Sdn Bhd [2009] MLJU1065	The subcontractor is entitled to payment due unsigned of the agreement.	Subcontractor
4.0	Globe Engineering Sdn Bhd v Bina Jati Sdn Bhd [2010] MLJU 311	Main contractor would be paid to subcontractor when they are paid by employer (pay when paid).	Subcontractor
5.0	United Exploration (M) Sdn Bhd v Ijm Corp Bhd [2011] 8 MLJ 161	The right to claim the balance of the sum owing under the subcontract due scope of works reduced.	Main Contractor
6.0	Ak Translogic Sdn Bhd v Kausar Corp Sdn Bhd [2011] 9 MLJ 415	Main contractor refused to pay a subcontractor's claim due to delay in completion	Subcontractor

		& defective works occurred.	
PERFORMANCE BOND			
7.0	Lec Contractors (M) Sdn Bhd (formerly known as Lotteworld Engineering & Construction Sdn Bhd) v Castle Inn Sdn Bhd & Anor [2000] 3 MLJ 339	Subcontractor reluctant to release a performance bond to main contractor when demand was made.	Main Contractor
VARIATION ORDER			
8.0	Esajadi Sdn Bhd v Ybs Tenaga Sdn Bhd [2011] MLJU 148	Main contractor refused to pay the amount of variation under subcontract claimed by the subcontractor.	Subcontractor
ARBITRATION			
9.0	Ng Ki Sian v Petaling Jaya Asset Sdn Bhd [1998] MLJU 403	Main contractor refused to settle the problem through the arbitration	Subcontractor
TERMINATION			
10.0	Kah Seng Construction Sdn Bhd v Selsin Development Sdn Bhd [1996] MLJU359	Termination of contract due suspension of work by subcontractor	Main Contractor

Table 2.0 shows some cases derived from problems when using the non-standard form. There were ten cases selected which involved were in various kinds of problems. The problems were performance bond (1 case), terms of payment (6 cases), variation order (1 case), arbitration (1 case) and termination (1 case). Payment problem contributed most when using non-standard form. This is because non-standard form do not create the possibility of a more balanced allocation of risk between the contracting parties. Hence, it creates a higher chance of disputes, especially in term of payment which is believed as the lifeblood of the construction industry.

Based on the case analysis, the judgment priorities to subcontractor were 6 of 10 cases (60%). In Malaysia construction industry, most of domestic subcontractors are in class E and F under PKK registration. Not all of them came from a technical background and some of them from low educational background but enrich with skills and expertise. In spite of lot of expertise in construction, their levels of understanding in the contract are still low. This is one of the constraints / reasons for the late implementation of standardized forms for domestic subcontract in Malaysia.

Whether Model Terms Can Minimize the Problems

Based from the case analysis, 9 out of 10 above cases can be minimized by Model Terms which payment (5 cases), variation order (1 case), termination (1 case), performance bond (1 case) and arbitration (1 case). Case of *Antara Antara Elektrik Sdn Bhd v Bell & Order Bhd [2002] 3 MLJ 321* was cannot be minimized the problem since dispute regarding terms of payment when various form applied not stated clearly in Model Terms but in law of contract, both parties must have mutual agreement regarding terms of payment.

Payment problem generally can be minimized by using Model Term as covers all the main payment provisions relating to the contract including payment claims, loss and expense claims, payment certificates, retention amounts and many others.

Undoubtedly, this finding is in line with research conducted by Hinze (2006) which mentioned more than a third of the subcontractors surveyed stated that on periodic payments, the retainage withheld from their payment was equal to that withheld by the owner from the general contractor. In addition, according to Sears & Clough (1994), retainage can produce cash flow problems for contractors and subcontractors, resulting in substantial borrowing at a sometimes hefty interest rate, which results in higher construction costs for owners.

CONCLUSIONS & RECOMMENDATIONS

The case analysis reveals that payment was the critical issue of subcontracting followed by damages, termination, variation, arbitration, delay and performance bond. Payment issues covered retainage withheld by main contractor, incorporation of the terms, claim for outstanding payment for work done / not fully paid, pay when paid clause etc.

Of the problem faced when using non-standard form, payment issues contributed most. The payment's cases covered in terms of set off by main contractor, incorporation by terms of payment, certificates and payment, claim for work done and pay when paid clause. It was found that Model Terms has a great possibility to minimize the problems faced by main contractor and subcontractors when using non-standard form

For better improvement in the construction industry, it is recommended the major organizations entrusted to play the important role in the construction industry such as Construction Industry Development Board (CIDB), Pusat Khidmat Kontraktor (PKK) and other non-government agencies should take a proactive solution to encourage the usage of Model Terms among the contracting parties. For examples, conducting seminars, Roadshows in order to enhance parties' awareness about standardized form.

Moreover, main contractors and subcontractors, especially domestic subcontractors need to shift their paradigm for choosing Model Terms as part as their contractual agreement. Thus, their right and duties will be protected and problems can be minimized under this standardized form of contract.

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