

Effectiveness Of Construction Industry Payment And Adjudication Act (CIPAA) In Remediating Payment Issues Among Sub-Contractors

Tay Zi Keng^{1,a}, Kong Sio Kah^{2,b}

^{1,2}INTI International University, Faculty of Engineering and Quantity Surveying

Corresponding author: ^aI12002018@student.newinti.edu.my, ^bsiokah.kong@newinti.edu.my

Abstract: Payment issues are prevalently rooted in the Malaysian construction industry, whereby upstream players have abused their payment obligation to force the downstream players such as Sub-Contractors to accept the onerous conditions. Meanwhile, there is no sanction for the default available in several Sub-Contract Agreements to facilitate the cash flow and yet, seeking dispute resolution from arbitration and litigation is expensive and time consuming. As a result, the unpaid Sub-Contractors with weak financial capacity are often forced to encounter severe cash flow problems and eventually led to adverse impact to construction industry. CIPAA was enacted in 2012 to facilitate regular and timely payment. However, the effect of adjudication decision is temporary binding, which might lead to a meaningless decision if it is resisted by losing party. Therefore, this research objectives are to identify the pertinent features of CIPAA in remediating payment issues and investigate the effectiveness of provisions set out under CIPAA in remediating payment issues. This study is targeted to the CIDB Grade 7 Sub-Contractors located in Selangor and Johor and quantitative questionnaires survey method is adopted. The results shows that CIPAA is an effective dispute resolution to overcome conditional payment provisions and it is able to minimize cash flow problems due to its speedier, contemporaneous and extensive remedies to recover payment. However, cost of adjudication fee and temporary binding decision under CIPAA are the major concern for Sub-Contractors to apply CIPAA as a dispute resolution.

Keywords: Effectiveness, CIPAA, payment.

INTRODUCTION

Under vision 2020, the biggest aim of Malaysia is to be fully developed in becoming a prosperous country with the development of building and infrastructure works, which has a direct linkage to the construction industry. In an attempt to uphold and sustain the image of construction industry, payment issues constantly become a chronic barrier that obstructs such effort (Ameer Ali, 2006). The practice of regular and timely payment in the construction industry is the major input in ensuring the success of a project (Mohd Danuli et al. 2013). According to Ameer Ali (2006), delay or non-payment practice could bring adversarial and harmful impact and subsequently affect the entire delivery chain in the construction industry.

Construction Industry Payment and Adjudication Act 2012 (CIPAA) was gazetted in June 2012 and enacted as a statutory adjudication act on 15th April 2014 in Malaysia in order to facilitate a regular and timely payment dispute by eliminating the prevalent practice of conditional payment in a cheaper and speedier medium of dispute resolution. Due to the recent legislation of this Statutory Act in Malaysia construction industry, the level of awareness toward CIPAA is expected to be low among the Sub-Contractors and thus a study of the effectiveness of CIPAA in assisting the Sub-Contractor to encounter payment issues is prompted in this research.

STATEMENT OF PROBLEM

Based on the Statistic from CIDB (2014), 44.1% of the Sub-Contractor reported that they have encountered late payment situation in government-funded projects while 53.5% of the Sub-Contractor experienced late payment in private funded project. This situation was happened because the upstream players abuse the payment obligation in the contract to force the downstream players to accept the onerous conditions such as pay-if-paid and pay-when-paid clauses, which eventually lead to insolvency and abandonment of the construction work.

Apart from that, existing alternative dispute resolution such as arbitration and litigation available in Malaysia construction industry is time consuming and expensive (Karib, Shaffii and Nor, 2008). Meanwhile, these dispute resolution might not be so effective in resolving cash flow problem due to certain limitation asserted by the dispute resolution. For example, arbitration can be initiated only after the construction work is completed or the contract is terminated, while the litigation can be initiated only if an arbitrator's award is being challenged (Ameer Ali, 2006).

Furthermore, the main purpose of CIPAA might be defeated if the adjudication decision is being challenged or set aside by High Court. In spite the adjudication decision is determined in the favor to the unpaid party by the adjudicator under CIPAA, the decision is temporary binding and may be subjected to arbitration and litigation. Based on the case “WRP Asia Pacific Sdn Bhd v NS Bluescope Lysaght Malaysia Sdn Bhd [2015] MLJU 112”, the adjudication decision was set aside due to the incompetence of adjudicator, whereby the unilateral communication was happened within the dispute determining period.

Due to the prevalent payment problems arise in the construction industry nowadays, it is believed that the downstream players (such as Contractors and Sub-Contractors) might become the victims affected by the current bad practice in Malaysia. CIPAA plays an important role in remedying payment issues by prohibiting conditional payment terms, providing a speedier and faster dispute resolution as well as remedies available to the unpaid party, which portray the good side for the CIPAA in remedying payment issues. However, the effectiveness of CIPAA in remedying payment issues might also be challenged since the adjudication decision is temporary binding and might be subjected to arbitration and litigation. In the presence of pros and cons reflected by the nature of CIPAA, it triggers the research to study the effectiveness of CIPAA and the extent of application of CIPAA in remedying payment issues among the Sub-Contractor.

OBJECTIVES OF RESEARCH

1. To identify the pertinent features of CIPAA in remedying payment issues;
2. To discuss the effectiveness of provision set out under CIPAA in remedying payment issues among Sub-Contractors.

EFFECTIVENESS OF CIPAA IN REMEDYING PAYMENT ISSUES

a) Prohibition of Conditional Payment Terms

Conditional payment practice is always a major issue that gives rise to the severe cash flow problem to the Sub-Contractors and brings adverse impact to the construction industry. In order to remove the bad payment practice, CIPAA was enacted as a Statutory Adjudication Act to outlaw the pervasive conditional payment practice such as pay-if-paid clause and pay-when-paid clause that mostly happened to the Sub-Contractors in the construction industry.

In the case of *Pernas Otis Elevator CO Sdn Bhd v Syarikat Pembinaan Yeoh Tiong Lay Sdn Bhd & Anor* [2004] 5 CLJ 34, the Sub-Contractor (plaintiff) who has completed the installation of lift in the stipulated timeframe but Employer rejected the payment due to excessive harmonic distortion caused by the lift installation. Meanwhile, conditional payment term of “pay-when-paid clause” was included in the sub-contract agreement that leads to the non-payment made by Main Contractor (defendant) as they have not received payment from the employer. In this circumstance, the plaintiff application was dismissed as the Court of Appeal held that the Sub-Contractor is only entitled to the payment when the Main Contractor has received the payment from Employer. However, the enactment of CIPAA has reversed the judicial decision in the above case as well as *Asiapools (M) Sdn Bhd v IJM Construction Sdn Bhd & Ors* [2010] 3 MLJ 7, which was also dealing with the conditional payment issue.

As a result, the provision of “Prohibition of Conditional Payment” set out under Section 35 of CIPAA is very effective in seeking justice for the unpaid Sub-Contractors to tackle the conditional payment conditions. Since all the conditional payment provision are void under the CIPAA and it prevails over any construction agreement, it can effectively impede the pervasive transfer of cash flow risk practice from upstream players to downstream players in the Malaysia construction industry (Rajoo 2012). Hence, CIPAA can significantly remove the severe cash flow problem arising from the imposition of conditional payment provision that happened among the Sub-Contractors.

b) Duration and Cost of CIPAA Process

The effectiveness of a dispute resolution can be influenced by the duration and the cost required by the process itself. According to Section 12 (2) under CIPAA, the adjudicator is given forty-five (45) working days from the service of adjudicator response or reply to determine the dispute and deliver the adjudication decision. As we compared to other dispute resolution available in the Malaysia such as Litigation, Arbitration and Mediation, CIPAA (statutory adjudication) process provided the shortest working duration and cheapest cost of payment dispute resolution, as shown in Table 1.

Table 1: Comparison of Salient Features between Litigation, Arbitration and Statutory Adjudication

Source: Noushad Ali Naseem Ameer Ali (2006)

Description	Litigation	Arbitration	Statutorily Adjudication
Tribunal Cost (RM)	5k	50k – 300k	8k – 90k
Parties’ Costs – both sides (RM)	100k – 600k	100k – 500k	50k – 100k
Duration	2 – 7 years	1 – 5 years	4 – 8 weeks
Timing	Anytime if no arbitration clause	May only be started after the termination or completion of the contract	Anytime

Based on Table 1, seeking resolution under CIPAA is much efficient and effective as it enables the unpaid Sub-Contractors to recover their payment in the shortest possible duration in order to minimize adverse cash flow problem arising from the payment defaults. However, according to Wilfred and Ivan (2014), their idea toward the time limit stipulated under CIPAA is too short and might not afford sufficient careful analysis of facts and evidences against a complicated issue in

order to determine a fair decision. Nevertheless, Alastair (2013) pointed out that complex decision could also be made within a short timeframe if the documents submitted are presented succinctly and obviously to convince the adjudicator to deliver a fair decision

However, according to Garth McComb (2013), even the duration for entire CIPAA process is considered short, the disputed payment may have been made in the subsequent payment certificates before the adjudication decision is concluded, as the adjudication process is within the period of honoring certificate of the subsequent certificates. Thus, the effort for the application of CIPAA might be valueless since the time and money incur during the adjudication decision would be wasted as the dispute has been resolved between both parties before the delivery of adjudication decision.

c) Remedies for Recovery of Payment

Suspension or Reduction of Work Progress

When the adjudication decision has been determined in favor to the Claimant (unpaid party), it provides the rights for the Claimant to suspend the construction work or reduce the work progress legally in the event of non-payment of wholly or partly of the disputed amount after the receipt of adjudication decision under Section 29 of CIPAA. Due to the presence of expressly provision set out under CIPAA in offering the right to suspend in the event of non-payment by the losing party, it is highly effective for the unpaid Sub-Contractors to suspend or “go slow” the work progress without having to repudiate the contract (*see Kah Seng Construction Sdn. Bhd. v Selsin Development Sdn. Bhd [1997] 1 CLJ*). Therefore, this can significantly facilitate their cash flow as suspension of works can be regarded as a self-remedy for the Sub-Contractors, who have not received the adjudicated payment (Chia Kuang L., 2009) and it can also be used as an effective means of securing the recovery of payment by pressurizing the unpaid losing party to settle the payment rapidly (Pettigrew, R, 2005).

Direct Payment from Pricipal

The claimant who is in favor in the adjudication decision has the rights to obtain the direct payment from the principal in the event of non-payment is made by the losing party under Section 30 of CIPAA. Direct payment from the principal is seemed to be an effective remedy for the unpaid Sub-Contractor to secure the recovery of payment swiftly during the construction period. However, the effectiveness of this remedy might be challenged if the construction project has been completed long time ago and how if the Client had fully released all the payment due to the debtor (Kamarulzaman, 2015). Nevertheless, it could be very effective to recover the payment from Client when dealing with conditional payment issues such as “pay-when-paid” and pay-if-paid” clauses, since the non-payment of the Main-Contractor is due to the non-payment from the Client. Apart from that, there will be a probability for the winning Sub-Contractor from the adjudication decision are given the options of paying in tranches after the adjudication decision is delivered (KLRC, 2016). However, it is still considered as an effective remedy to recover the payment as it could at least assist the Sub-Contractor to minimize the adverse impact of cash flow problem due to non-payment.

Enforcement of Adjudication Decision

The winning party may enforce the adjudication decision by applying to High Court for an order to secure the recovery of payment. In this circumstance, the order of the adjudicated amount has become a judgment by the High Court, which must be followed and obeyed meticulously by the losing party. In the legal point of view, it seemed to be one of the most effective ways to secure the

recovery of their payment as nobody could abstain from judge order once the decision has been enforced. Nevertheless, the enforcement of adjudication decision could often be challenged and resisted by losing party by pleading on the ground stated under Section 15 of CIPAA, which will be further discussed in the next section.

d) Effect of Adjudication Decision

Despite the adjudication decision is determined in the favor of Claimant, the Adjudication decision is still subjected to temporary binding. The Claimant has the rights to enforce the adjudication decision by applying to the High Court for an order under Section 28 (1) of CIPAA to secure the recovering of disputed payment from the Defendant. However, losing party may resist the enforcement of Adjudication decision by imploring any of the grounds under Section 16 (1a) of CIPAA. Therefore, the main purpose of CIPAA, which is to sustain the cash flow problem might be opposed if a stay of adjudication decision is granted, which lead to valueless adjudication decision as there is no mandatory security of recovering payment under CIPAA (Rajoo, 2014).

In the case of *WRP Asia Pacific Sdn Bhd v NS Bluescope Lysaght Malaysia Sdn Bhd [2015] MLJU 1125*, the adjudication decision was set aside due to the incompetency of adjudicator during the adjudication process, whereby an Whatsapp message was sent by the Adjudicator to the Claimant without copying to the defendant. If there were no unilaterally communication between the adjudicator and claimant, the claimant would have entitled for the adjudicated amount as well as rights and remedies provided under adjudication decision. Therefore, the competency of adjudicator is very important when deciding and delivering a proper adjudication process (Garth McComb, 2013).

In the case of *Foster Wheeler E&C Malaysia Sdn Bhd v Arkema Thiochemicals Sdn Bhd, [2015] 1 LNS 632*, the High Court was asked to determine an issue of granting a stay of an adjudication decision. After the adjudication decision was delivered, Foster Wheeler (Contractor) applied to enforce the adjudication decision in its favor. However, the employer attempted to resist the enforcement and seek for a stay on the enforcement on the ground that the adjudication decision is pending for final determination by arbitration, which has been proffered under Section 16 (1) (b) under CIPAA. Thus, the High Court rejected the Employer's application and abstained from issuing a stay in adjudication decision because the objectives of adjudication such as temporary and provisional finality are slightly difference from arbitration.

Based on the above cases, we can merely say that temporary binding adjudication decision under CIPAA is the major concern in dealing with its effectiveness, which is critically rely on the competency of adjudicators in determining the adjudication decision as well as depend on the wisdom of High Court in either enforcing or set aside the adjudication decision (Fong, 2012). Hence, the extent of application of CIPAA among Sub-Contractors will be further discussed in the next section since it has a direct linkage on the effectiveness of CIPAA.

RESEARCH METHODOLOGY

Mean Score (MS) is adopted to determine the effectiveness level of CIPAA in each category. According to website published by University of Leicester (2016), MS is used to analyze the dataset that are comparatively spread evenly with no exceptionally high or low values, which is suitable for this study since the maximum score in this study is 5. After the results have been collected, Mean Score Index (MSI) would be calculated using Microsoft Excel to determine the average effectiveness level among the overall respondents.

DATA ANALYSIS

Effectiveness of CIPAA in Remediating Payment Issues among Sub-Contractors

a) Prohibition of Conditional Payment Terms

Table 2: Result of Effectiveness of Prohibition of Conditional Payment Terms under CIPAA

Effectiveness Level	Score	Frequency	Total Score
Highly Not Effective	1	0	0
Not Effective	2	1	2
Moderate	3	8	24
Effective	4	24	96
Highly Effective	5	3	15
Total		36	137
Mean Score = 137/36 =			3.81

Table 2 shows a mean score of 3.81, which indicates the effectiveness of prohibition of conditional payment terms is tend to be closer to the position of “effective”.

b) Cost and Duration of CIPAA Process

Table 3: Result of Effectiveness Level on Cost and Duration of CIPAA Process

Effectiveness Level	Score	Frequency	Total Score
Highly Not Effective	1	1	1
Not Effective	2	5	10
Moderate	3	20	60
Effective	4	9	36
Highly Effective	5	1	5
Total		36	112
Mean Score = 112/36 =			3.11

According to Table 3, it shows a mean score of 3.11, which entails the effectiveness of cost and duration of CIPAA is tend to be closer to the position of “moderate”.

c) Remedies for Winning Party to Recover Payment after Adjudication Decision

Suspension/Slowdown of Work Progress and Entitlement of Extension of Time & Loss and Expenses

Based on the data obtained, there were 20 respondents (56%) agreed that suspension or slowdown of work progress could pressurize the losing party to settle the payment rapidly after the adjudication decision is delivered. In contrast, the remaining 16 respondents (44%) disagreed with this statement. Since the percentage for each result is closer to each other, it could be explained in two types of situation.

Request Direct Payment from Client

Based on the result obtained, majority of the respondents (67%) viewed that no problem would be faced when requesting direct payment from the Client, which means they are able to receive the whole adjudicated amount fully without any difficulties. In contrast, there were 8 respondents (22%) viewed that the payment would only be paid in portion. Even though the payment is only paid in tranches, it is still considered a minor remedy for unpaid Sub-Contractors to recover the payment as it could at least minimize the severe cash flow impact due to non-payment.

Apart from that, there were 4 respondents (11%) viewed that the payment would be rejected as Client claimed that he has fully released the payment to Main Contractors. In this situation, the Evidence Act would come into force to determine the validity of the proof of payment made. In the absence of proof of payment, the Client shall pay the adjudicated amount to the winning unpaid Sub-Contractors within 10 working days after service the notice of request.

Enforcement of Adjudication Decision

Based on the data collected, there were 29 respondents (81%) agreed that the losing party would make the payment after the enforcement of adjudication decision, since the adjudication decision has become a judgment and nobody could be abstained from judge order. However, there were 7 respondents (19%) disagreed with this idea and they viewed that the losing party would try to resist the adjudication decision by pleading on the ground stated under Section 15 of CIPAA. If the adjudication decision that is favourable to the unpaid Sub-Contractor was enforced, this would be the most effective remedy to recover the payment; however the adjudication decision would be valueless if it was set aside by High Court. Therefore, we could conclude that the effectiveness of this remedy is still highly dependent on the High Court’s decision in either enforcing or set aside the adjudication decision.

d) Effect of Adjudication Decision

Table 4: Brief Summary of CIPAA Cases Decided by High Court

Case	Ground of Setting Aside	Final Result of High Court
A	Adjudicator overlooked the counter-claim in adjudication response	Enforced. Jurisdiction of adjudicator is only limited to payment claim and payment response.
B	Adjudicator has not acted independently due to unilateral communication among Adjudicator and one party	Set aside. Breached the rules of fair play since adjudicator failed to afford same opportunity to other party.
C	Failing to state the reason of adjudication decision in detail	Enforced. No requirement to state a detail reason, as long as it is sufficient to show the statement of reasoning for the decision.

Table 4 above shows two out of three cases that the adjudication decisions effectively enforced.

CONCLUSION

In a nutshell, CIPAA is an effective dispute resolution to overcome conditional payment terms and it is able to minimize cash flow problems because it is speedy, contemporaneously and provides extensive remedies for the recovery of payment. If the adjudication decision is being challenged by losing party, then the effectiveness of CIPAA is critically relied on the competency of adjudicators in delivering the issues and wisdom of High Court in judging the issues.

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