Construction Law Digest

A SOCIETY OF CONSTRUCTION LAW, MALAYSIA NEWSLETTER

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MESSAGE FROM THE PRESIDENT

Welcome to the first issue of the CONSTRUCTION LAW DIGEST.

It is my great pleasure to launch this inaugural issue of the Construction Law Digest with the intent of providing a forum for lawyers and other professionals and stakeholders in the construction industry to publish their contributions and to disseminate their knowledge about developments in the field of construction law and practice, both within the country and overseas.

The Construction Law Digest is the first newsletter published by the Society of Construction Law, Malaysia (previously known as the Society of Construction Law – Kuala Lumpur & Selangor) since its inception in 2004. The Society of Construction Law, Malaysia has strong links with its sister Societies of Construction Law based in the United Kingdom, Australia, Singapore, Hong Kong, New Zealand, Mauritius, the Caribbean, the Gulf States (UAE, Bahrain, Qatar) and Europe.

In this first issue, we have an interesting array of articles and case notes in the context of recent developments in construction law and practice contributed by the members of the Societies of Construction Law in Malaysia and in other jurisdictions, such as Australia, Singapore and Hong Kong. The contributions from the members of other jurisdictions may serve as useful guides and/or persuasive authorities for Malaysia.

The coverage of the Construction Law Digest includes an event to be organised by the Society of Construction Law, Malaysia, namely, the Vincent Powell-Smith Prize Essay Writing Competition which is modelled after the highly acclaimed Hudson's Prize, and the up-coming Fourth International Construction Law Conference jointly organised by the Society of Construction Law, Australia and Society of Construction Law, New Zealand which will be held in Melbourne, Australia from 6 – 8 May 2012.

I would like to thank the Editors for their hard work and enterprise in producing this newsletter. I would also like to cordially thank the authors for their excellent support and timely contributions to this newsletter.

The Editors and I are looking forward to bringing you more interesting articles and case notes in the coming issues. Thank you for your support.

Wilfred Abraham
President,
Society of Construction Law, Malaysia

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THE SOCIETY OF CONSTRUCTION LAW, MALAYSIA

proudly announces the introduction of the

Vincent Powell-Smith Prize
Essay Writing Competition

Modelled along the highly acclaimed Hudson Prize, this competition is for essays on subject matters related to **Construction law of MALAYSIA**

It offers entrants:

1st Prize : RM5,000 and a trophy
2nd Prize : RM2,000 and a trophy

(Commendations may also be awarded)

with winning entries to be published by SCL Malaysia

Topics could be in relation to any aspect of Construction law of MALAYSIA - Construction & Engineering Contracts; Dispute Resolution / Avoidance; Arbitration; Litigation; Company Law; Taxation; Torts. Maximum of 5000 words.

Entries are invited from all disciplines. Entries could be from engineers, lawyers (including pupils in chambers), lecturers, quantity surveyors and post-graduate students.

The Panel of Judges will allocate marks based on:

- Originality of thought or approach and contribution to the study or practice of construction law or its applications in the industry
- Quality of analysis, explanation and discussion of chosen topic
- Freshness of ideas and the value of the work
- Clarity of presentation, grammar, spelling, punctuation and any referencing

Details of the competition will be published soon.
For more information, please email to **lam@skrine.com** or **thaya@zulrafique.com.my**


Thayananthan Baskaran[1] and Imran Ismail[2]

IF AND WHEN
THE INTERPRETATION OF "PAY WHEN PAID" CLAUSES

INTRODUCTION

It is the norm in the construction industry for a main contractor to sub-contract part of the works to a sub-contractor. The sub-contract will often provide that the main contractor will pay the sub-contractor, when the main contractor receives payment from his employer. Such a provision in a sub-contract is called a "pay when paid" clause. "Pay when paid" clauses are prevalent in Malaysia, although they are not provided for in the two main domestic standard forms of contract i.e. the PWD Form 203N (Rev 1/2010) and the PAM Sub-Contract 2006. This article will examine how our courts have dealt with "pay when paid" clauses.

INTERPRETATION

The courts in Malaysia have considered the question of enforceability of pay when paid provisions as primarily a matter of interpretation. For example, the High Court, in *Pernas Otis Elevator Co Sdn Bhd v. Syarikat Pembenaan Yeoh Tiong Lay Sdn Bhd & Anor* [2004] 5 CLJ 34 at pp 39, 43-44, interpreted a clause that reads as follows:

"Payment in respect of any work, material or goods comprised in the subcontract shall be made within seven (7) days after receipt by the Contractor from the Employer"

to mean:-

"… In our present case, the effect of cl. 2.3 of the subcontract is the same. Clause 2.3 is clear and unambiguous, in that the defendant (the main contractor) is only liable to pay the plaintiff (the subcontractor) when the defendant had received the said payment or sum from the employer and the payment to the plaintiff must be made within seven days after the receipt of the said sum by the defendant. There is no reason why this court should not follow the same interpretation as that of the courts in Singapore and Hong Kong over the said provisions. In coming to the above decision, the court has to consider the interest of the main contractor as well as the interest of the out-of-pocket subcontractor; the freedom of contract and the fact that contracts may differ from case to case. A "pay when paid" clause in one contract may be worded differently from another. Clauses such as cl. 2.3 in our present case, are common industry clauses, which must be accepted by the parties with the knowledge of the attendant risks. The problem arises only when the employer fails to pay the main contractor. Parties (main contractors and subcontractors) are free to negotiate their contracts and agree to whatever terms in the agreements or contracts unless they are prohibited by law. While the courts will readily wrap a caring arm around the weak and

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the meek, they cannot do so in every instance. Everyone negotiates his own contract. He is at liberty to give and take as much as he can mutually agree with the other side. The subcontractor per se is not a special species who requires special principles of law to give him a generous dose of legal protection."

Here, the High Court gave the "*pay when paid*" clause its literal meaning and dismissed arguments that such clauses are unfair.

However, the Court of Appeal, in *Antah Schindler Sdn Bhd v Ssangyong Engineering & Construction Co Ltd* [2008] 3 MLJ 204 at para 5, 15-16, interpreted a similar clause that reads:

"That payment in respect of any work, materials or goods comprised in the sub-contract shall be made within 14 days after receipt by the Contractor of payment from the Employer against the architect's certificate under clause 30 of these Conditions which states as due in amount calculated by including the total value of such work, materials or goods, and shall when due be subject to the retention by the Contractor of the sums mentioned in sub-paragraph (viii) of para (a) of this Condition."

to mean:-

"15. By the very language alluded to in the relevant provisions of the current main contract and subcontract, read together with cl 27(a)(vii), we had construed the latter as a mere provision imposing a time limit for payment. We found no express provision mounted into it which imposed any restriction over the rights of the plaintiff to pursue its claim against the defendant. Master Towle in Smith & Smith Glass Ltd v Winstone Architectural Cladding Systems Ltd [1992] 2 NZLR 473 had occasion to state:
While I accept that in certain cases it may be possible for persons contracting with each other in relation to a major building contract to include in their agreement clear and unambiguous conditions which have to be fulfilled before a subcontractor has the right to be paid, any such agreement would have to make it clear beyond doubt that the arrangement was to be conditional and not to be merely governing the time for payment. I believe that the contra proferentem principle would apply to such clause and that he who seeks to rely upon such a clause to show that there was a condition precedent before liability to pay arose at all should show that the clause relied upon contain no ambiguity.
16. It was our view that, since it was not unambiguously expressed in cl 27(a)(vii) that the plaintiff was to be denied its rights from pursuing the claim in the current format, this action was procedurally correct. We now discuss the merit of the appeal."

The Court of Appeal, in *Antah Schindler* supra, strictly interpreted the "*pay when paid*" clause to be effectively unenforceable, as it did not expressly provide that payment by the employer to the main contractor would be a condition precedent to the main contractor paying the sub-contractor.

This interpretation gave rise to the distinction between "*pay when paid*" and "*pay if paid*" clauses. "*Pay if paid*" clauses that expressly make payment by the employer a condition precedent to the main contractor paying the sub-contractor are enforceable. While "*pay when paid*" clauses that do not have such express conditions precedent are effectively unenforceable, as they are said to merely regulate the time for payment.

The distinction however is somewhat tenuous, as clauses with almost identical wording have been interpreted as either "*pay when paid*" or "*pay if paid*" clause. The clauses considered in *Pernas Otis* supra and *Antah Schindler* supra are themselves almost identical.

Subsequently, the Court of Appeal, in *Asiapools (M) Sdn Bhd v IJM Construction Sdn Bhd* [2010] 3 MLJ 7 at para 15, 25, inter alia, held:

"15. At this juncture, it is appropriate for us to refer to cl 13.01 which reads as follows:
13.00 Progress Payment/Interim Payment
13.01 Notwithstanding the provision of Clause 27 pertaining to nominated sub-contractor and the payment for works executed, it is hereby agreed that in the event of any interim certificate which includes, for nominated sub-contract works, the payment in respect of any works, 75% material or goods comprised in the sub-contract shall be made to the sub-contractor within 14 days after receipt by the Main Contractor of payment certified as due in the Interim Certificate from the Client i.e. Messrs Ng Chee Yee Sdn Bhd.
...

25. Reverting to the instant appeal, in ordinary parlance, 'progress payment' portrays any payment according to 'progress' ie the forward movement of the works. 'Progress payment' clearly includes a payment at any stage, from the first stage, to the second stage, culminating in the final stage ie the final payment. Upon the true construction of cl 13.01, in particular the expression 'progress payment', we are of the view that it is sufficiently wide to include the final payment claimed by the plaintiff, in which case, the plaintiff is only entitled to payment after the defendant has been paid by the employer, Hence, we are unable to sustain the submission presented for the plaintiff."

Again, the clause was almost identical to those in *Pernas Otis* supra and *Antah Schindler* supra, but the Court of Appeal held that the clause was enforceable on its literal interpretation.

The Federal Court, in *Seloga Jaya Sdn Bhd v UEM Genisys Sdn Bhd* [2010] 3 MLJ 721 at para 2, 23, 27-28, interpreted the following clause:

"You have agreed that payment will be made to you within Forty Five (45) days from the date of receipt by the contactor of any certificate of duplicate copy thereof from the Architect or until receipt of main contract payment from the Employer, whichever is later."

to mean:-

"23. To cushion themselves from excessive loss in the event of the employer becoming insolvent and when the subcontractor has completed his work, some main contractors have resorted to drafting into the subcontract a 'pay when paid' clause. This literally means that the subcontractor will only be paid when the main contractor gets paid by the employer. Clause 10 in the agreement between the parties in this case is of this nature. But the issue in this case goes beyond this: can the main contractor after having been paid by the employer in the form of stocks rather than money in turn settle with the subcontractor in the same form he obtained from the employer?
...
27. The essence of the third ground of this appeal is the construction by the courts below on the means of payment is wrong on the face of the factual matrix of this case. Regrettably we disagree. In both the letter of offer by the appellant to the respondent dated 30 November 1994 and the subsequent formal agreement entered into by the parties, the contract sum is explicitly spelled out in words as well as in figures with the currency fixed as 'Ringgit Malaysia'. Apart from this, there is no other form of payment ascribed. So upon the plain construction of these words in the contract between the parties, there can be no other form of payment or settlement with the respondent except by money 'upon receipt of main contract payment from the Employer' which the appellant did when they accepted the said FGB ICULS stock.
28. The appellant has argued before us that they have no option to reject these stocks as payment by the employer. This is not correct. From the correspondence found in the appeal record, we observed that the appellant did not object to this payment in the form of FGB ICULS stock nor register with scheme of companies their refusal or that of the respondent to accept this kind of payment. Having accepted this from the employer as payment for the main contract debt then under the terms of the subcontract, the appellant has no option except to pay the respondent in the form as stipulated – money rather than by the stock described."

The Federal Court enforced the "*pay when paid*" clause in its literal sense, although from the report, there appears to have been no argument as such on the various interpretations of such clause. The conflicting judgments of the Court of Appeal in *Antah Schindler* supra and *Asiapools* supra are notably not referred to in the report on *Seloga Jaya* supra.

A fairly recent judgment of the High Court, in *Rira Bina Sdn Bhd v. GBC Construction Sdn Bhd* [2011] 2 MLJ 378, at para 1, 68-70, 88, recognised the distinction between "*pay when paid*" and "*pay if paid*" clauses, when it was inter alia held:

"1. Different industries have different legal lingo with its own peculiar interpretation and the construction industry is no exception. Often bandied about as they may appear convenient are the terms 'pay when paid' and 'pay if paid'. Are the two terms materially different one from the other and can the terms of a construction contract where payments are to be made within 30 days upon issuance of the certificate be transformed into a 'pay when paid' or 'pay if paid' contract by the conduct of the parties? These issues shall be explored as counsel for both the parties expounded on the interpretation of the contract and the implications of their clients' actions.
...
68. In this regard the authorities clearly make a vital distinction between:

(a) a 'pay when paid" condition, which merely means the contractor can delay payment until the same is received from the employer of the main contractor up to a reasonable time; and
(b) a 'pay if paid' clause which grants the contractor absolute protection against payment to the subcontractor until and unless payment is made by the employer of main contractor, as pointed out in Engineering & Construction Contracts Management – Post Commencement Practice, (2002), LexisNexis by Ir Harbans Singh KS at pp 385-392.

69. A 'pay when paid' clause has never been interpreted to be an absolute bar to payment. On the other hand a 'pay if paid' clause must be clear and unambiguous in its effect before the court will lend credence to it...
70. The defendant's counsel therefore submitted that, in light of the vague and ambiguous terms of the 'pay when paid' condition, this court cannot hold that such a condition bars the defendant from payment. This is even more so since the plaintiff is unable to even precisely define the terms of this alleged condition. In the light of the authorities cited I would agree with the defendant's counsel that a 'pay when paid' condition, even assuming for a moment that it had been agreed upon, does not prevent the defendant from claiming the final sum of RM2,439,228.22 from the plaintiff forthwith
…
88. A one syllable word such as 'when' and 'if' in the context of a construction contract payment clause whether it be 'pay when paid' or 'pay if paid' is not as innocuous as it appears to be; indeed it has implications of far

The courts have treated the question of enforceability of "pay when paid" or "pay if paid" clause as one of interpretation.

reaching consequences. Only those in the construction industry are perhaps most aware and appreciative of this for they are most affected by it as payment is the lifeblood of the industry."

Unfortunately the judgments in *Asiapools* supra and *Seloga Jaya* supra do not appear to have been referred to and reliance only appears to have been placed on *Antah Schindler* supra.

CONCLUSION

The courts have treated the question of enforceability of "*pay when paid*" or "*pay if paid*" clause as one of interpretation. However, clauses with almost identical wording have been held to be either enforceable or unenforceable. The distinction made between "*pay when paid*" and "*pay if paid*" clauses also appears tenuous, as businessmen like main contractors who provide that they will pay their sub-contractors when they receive payment from their employer must intend such payment by their employer to be a condition precedent.

The uncertainties with respect to the enforceability of "*pay when paid*" clauses are likely to be resolved soon by the legislature, rather than by our courts. The Construction Industry Payment and Adjudication Bill is expected to provide that all "*pay when paid*" clauses are void.

Although the legislation, when it comes into force, will be welcome insofar as it provides certainty, the policy considerations appear unclear. The reason for the prohibition of these clauses is understood to be a desire to curb the pervasive unfair cash flow risk transfer practice. However, as some of the judgments of our courts have said, there is no commercial reason why the risk of the employer's insolvency should not be shared between a main contractor and sub-contractor. This would be especially so where the employer has himself nominated a sub-contractor to be appointed by the main contractor. Furthermore, as recognised in *Pernas Otis* supra, the "*subcontractor per se is not a special species which requires special principles of law to give him a generous dose of legal protection*".

The policy considerations behind the expected prohibition of these clauses appear misplaced, however to the extent that certainty is achieved, and arguments need no longer be made as to the tenuous distinction between a "*pay when paid*" and "*pay if paid*" clauses they are to be welcomed.

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RETENTION MONIES : YOURS OR MINE ?

It is common to find a provision in a standard form building contract which allows an employer to retain and hold a specified percentage of the amount certified in an interim certificate of payment for the work done and materials supplied by the contractor to ensure repair by contractor within the defect liability period of any defect in the construction works.

Based on English law, the contractor will not be able to claim for the release of the retention monies in the event the employer goes into liquidation or has a winding up petition presented against it, if the employer has not put the retention monies into a designated account separate from its general funds. This is the position notwithstanding that the contract specifically provides that the retention monies are to be held by the employer as fiduciary on trust for the contractor.

In the recent case of Sediabena Sdn Bhd & anor v Qimonda Malaysia Sdn Bhd (in liquidation), the High Court decided not to follow the English position, but instead held that the retention monies under the contract are monies held in trust by the employer in favour of the contractor, and as such, the contractor as beneficiary of the monies was still entitled to claim for their release after the employer has gone into liquidation even though the retention monies were not set aside in a designated account separate from the employer's general funds.

BRIEF FACTS

The Plaintiffs were the Defendant's contractors for a project known as the 'Design and Build For Qimonda Global Module House Project at Senai Johor' ("Works") which adopted the Singapore REDAS Design and Build Contract ("Contract"). Retention monies were deducted by the Defendant from the Plaintiffs' interim certificates for the purpose of making good defects in the Works carried out by the Plaintiffs during the liability period ("Retention Monies"). The Contract did not expressly state that the Retention Monies were held by the Defendant as a 'fiduciary' for the Plaintiffs.

The Defendant went into voluntary liquidation before the Retention Monies were released to the Plaintiffs and Liquidators were appointed over the Defendant. The Retention Monies were not set aside in a separate account prior to the Defendant's liquidation.

The Plaintiffs requested that the Retention Monies be released to them under the Contract. However, the Liquidators refused to do so contending, in the main, that the Retention Monies are not trust monies as there was no express trust provision which provided for the Retention Monies to be held by the Defendant as a 'fiduciary' in favour of the Plaintiffs. The Liquidators also contended that as the Retention Monies were not separated prior to the liquidation of the Defendant, they had become part of the general liquidation fund and that the release of the same to the Plaintiffs would constitute a preferential treatment to the Plaintiffs over the other creditors of the Defendant who have a right to the liquidation fund.

As a result, the Plaintiffs sought a declaration in the High Court that the Retention Monies were held in trust by the Defendant for the Plaintiffs and for a further order that the Retention Monies be released to the Plaintiffs.

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DECISION OF THE COURT

The issues for decision by the High Court were, in the main, whether the Retention Monies held by the Defendant were trust monies; and whether the Plaintiffs were still entitled to claim for the release of Retention Monies which had not been set aside in a separate account prior to the Defendant's liquidation.

The High Court granted the declaration sought by the Plaintiff, namely that the Retention Monies were trust monies and further ordered the Defendant to release the same to the Plaintiffs.

The Learned Judge took the view that the Retention Monies was, by its nature and purpose, trust monies because the Retention Monies could be deducted by the Defendant for only one purpose, namely, to rectify any defects during the liability period. The absence of any express provision for trust in relation to the Retention Monies did not dilute the Plaintiffs' beneficial interest in such monies. His Lordship was of the opinion that there was a legitimate expectation on the part of the Plaintiffs that the Retention Monies would be released to them if no claim was made against them under the Contract for defective or uncompleted Works.

The Learned Judge also took the view that there was no requirement for the Plaintiffs to take steps to ensure that the Retention Monies were set aside before the Defendant's liquidation in order to safeguard the Plaintiffs' beneficial interest in such monies. The fact that the Retention Monies were not set aside prior to the Defendant's liquidation did not raise the issue of preferential treatment to the Plaintiffs over the other creditors as the Retention Monies did not belong to the Defendant in the first place.

The High Court held that the act of separating the Retention Monies would be useful, but by no means conclusive evidence of the creation of a trust. The Judge took the view that the requirement for the separation of the Retention Monies would impose an extremely high obligation upon the contractors to safeguard the retention funds during the performance of a contract, and more often than not, would not reflect the commercial reality of the construction industry, particularly in the Malaysian context.

The Learned Judge also highlighted that the reported case laws in Malaysia would reveal only a handful of cases where the contractor had actually applied for the preservation of the retention monies during the pendency of a contract, and there could be many reasons why the fund was not set aside, the obvious ones being that the contractor would not want to jeopardise the commercial relationship of the parties when the contract was subsisting as the contractor would not really apply his mind to taking such action to preserve the retention funds especially when the employer was paying monies under the payment certificates.

In coming to its decision, the High Court chose not to follow the long line of established cases in England for the proposition that the failure by a contractor to take steps to ensure that the retention monies are set aside in a separate account would result in the contractor losing his right to claim for their release in the event of the employer's liquidation.

With this decision, contractors in Malaysia will be assured that, notwithstanding the liquidation of the employer, their beneficial interest in the retention sum will be safeguarded even though the employer did not set aside the retention sum in a separate account prior to its liquidation. This High Court decision is certainly one that all contractors in Malaysia will welcome.

CLOSING NOTE

The Defendant's appeal to the Court of Appeal was dismissed on 12 July 2011.

The Defendant's application for leave to appeal to the Federal Court was dismissed on 31 October 2011.

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TAXATION OF THE PROPERTY DEVELOPMENT INDUSTRY

INTRODUCTION

Taxation of income derived from the business of property development is often technical and complicated as the nature of the industry's business is such that development projects are often carried out in phases which stretch out over a number of years of assessment to complete.

In order to understand the rules under which the property development industry in Malaysia is taxed, one has to be familiar with the Public Ruling No. 1/2009 ("Ruling") entitled 'Property Development' issued by the Inland Revenue Board ("IRB") on 22 May 2009. The 2009 Ruling superseded an earlier ruling issued by the tax authority in 2006 on the same subject. It should be noted from the onset that the Ruling although instructive is nevertheless only reflective of the IRB's interpretation of the relevant provisions of the Income Tax Act 1967 ("ITA") and that the authority's views are often questioned and can be challenged in a court of law.

This article aims to provide its readers with an overview of the salient tax concept and issues concerning the property development industry through the examination of some of the pertinent tax rules provided for in the Ruling, including the rules governing the deemed commencement date of a business and completion of a project, recognition of income as well as deductibility or otherwise of various outgoings and expenses.

DATE OF COMMENCEMENT OF BUSINESS

The Ruling provides that a property development business shall be deemed to be commenced on a date when some significant activities or essential preliminaries to the normal operations of property development are undertaken. Examples given of such significant events include:

(i) the physical possession of the development site;
(ii) the active development of the land such as levelling of land or piling works; and
(iii) booking of properties by end purchasers.

The date of commencement of a property development business is important for tax purposes to a property developer as it would have a bearing on the deductibility of certain expenses incurred prior to the commencement of business.

As a rule, general administrative overhead expenses, such as salary, printing, stationery and other general expenses which are not directly attributable to a development project, but nevertheless incurred prior to the date of commencement of the business, are not tax deductible. On the contrary, the same expenses would be allowed for tax deduction if they are incurred after the commencement of the property development business.

Those expenses which are directly attributable to the development project such as land cost, survey fees, architect fees, conversion premiums, quit rent, assessment and soil investigation costs, which are typically incurred very early on in a project can be capitalised as development expenditure. Such development expenditure will only be accorded a revenue deduction on a progressive basis according to the stages of completion of the project.

RECOGNISING PROFITS ACCORDING TO PERCENTAGE OF COMPLETION

The gross income of a property developer is assessed on a receivable or accrual basis as opposed to a received basis. This requires the matching of revenues to expenses at the time at which the transaction occurs rather than when payment is made or received.

For tax purposes, the 'Percentage of Completion' method of accounting is adopted in the computation of income, whereby income from a property development business is to be recognised, as development activity progresses, by reference to the stage of completion of the development activity.

The 'Completion of Contract' method of accounting is not acceptable to the IRB for the computation of gross profit for tax purposes. The Ruling provides that a property developer who prepares its accounts on this basis must be prepared to re-compute its income by using the 'Percentage of Completion' method to determine and declare its estimated profits or losses annually.

A salient feature of the 'Percentage of Completion' method of recognising income and expenses is that it enables the tax authority to assess the profits of the property developer on a yearly basis based on the anticipated profit during the duration of the development, with a final tax adjustment to be made upon the completion of the project. This requires an exercise by the property developer to estimate the gross income from a development project.

Income recognition commences when the sale of the development units is effected (e.g. when the sale and purchase agreements are signed) and when development activities have commenced.

DETERMINING ESTIMATED GROSS PROFIT

The stage of completion of a development project and hence the estimated gross profit from a development project for a particular year of assessment may be determined in a number of ways. The common methods include:

(i) progress billings basis;
(ii) costs incurred to date basis; and
(iii) surveys of work performed basis.

As a rule of thumb, the IRB adopts the following formula based on progress billings to determine the estimated gross profit for any particular year of assessment:

Estimated gross profit (for a year of assessment)	=	Sum of progress payments in respect of the project, received and receivable in that basis period / Total estimated sale value of the project	X	Total estimated gross profit from the project

The tax authority may allow a property developer to use a formula other than the above to estimate its gross profit for a year of assessment. Another common formula used in the industry is the cost incurred to date basis, which appears like the formula below:

Estimated gross profit (for a year of assessment)	=	Costs incurred to date in respect of a project, paid and payable in that basis period / Total estimated costs of the project	X	Total estimated gross profit from the project

The formula chosen by a property developer must in any event be one that is consistent with accepted accounting standards that reflect a fair and reasonable spread of the estimated gross profit, and be applied consistently throughout the duration of the project.

ESTIMATED LOSS TO BE SET OFF AGAINST OTHER PROFIT MAKING PROJECTS

If a property developer anticipates that it will incur a loss in one or more of its property development projects in a basis period for a year of assessment, the estimated loss or aggregate of estimated loss from those projects can be set off against the aggregate of the estimated gross profits from its other profit making projects for the same basis period.

Any excess of estimated loss after the set off is disregarded.

REVISION OF ESTIMATES AND TAX COMPUTATION

It is often the case that the anticipated profitability of a project may fluctuate during the course of its development due to competing market forces that are not within the developer's control. It is for this reason that the IRB allows a property developer to revise its estimated gross profit or loss under the following circumstances:

(i) when there is a variation in the development cost of the project;
(ii) when there is a variation in the

selling price of the development units of the project; or

(iii) for any commercial reasons that may be acceptable to the Director General of Inland Revenue ("DGIR").

Although the revised estimates may be accepted by the IRB on a case by case basis, the revised figures for cost and revenue, even if allowed, can only be incorporated for the purpose of assessing the developer's current and subsequent years of assessment. Prior years' assessments calculated based on the original estimates would not generally be allowed to be reopened.

DATE OF COMPLETION OF PROJECT

The Ruling provides that a property development project shall be deemed to be completed upon the issuance of the Temporary Certificate or Certificate of Fitness for Occupation (CFO), or any other certification of similar effect, such as the Certificate of Completion and Compliance (CCC), whichever is the earlier. The date of completion is important for tax purposes as the property developer is required under the Ruling to ascertain its actual gross profit or loss from the project by preparing a final account upon the completion of the project. It is to be noted that the preparation of such final account may not be that straight forward as certain expenses attributable to the development, such as liquidated and ascertain damages (LAD) and strata title expenses, may be incurred some months or even years after the final account is required to be submitted.

Be that as it may, once the final account is prepared and the final figures become available, the actual profit or loss from the project, as the case may be, can be ascertained.

The following three situations may arise:

(i) Actual gross profit exceeds estimated gross profit.

- If this situation arises, the amount equal to the excess profit shall be taken as gross income for the final basis period and taxed accordingly.

(ii) Actual gross profit is less than estimated gross profit.

- Under this scenario, the property developer may choose to reopen all the prior years' assessments to have its actual profit apportioned and the affected assessments revised. The property developer may also choose not to have its preceding years' assessment reviewed. This would be allowed if the DGIR is satisfied that there are no tax implications in the developer so opting.

(iii) The property developer incurs an actual loss.

- If a project finally ends in a loss, the actual gross loss has to be apportioned to each relevant year of assessment.

DEDUCTIBILITY OF OUTGOINGS AND EXPENSES

As a general rule, all outgoings and expenses incurred wholly and exclusively by a property developer in the production of its income during the basis period in a year of assessment are deductible from the gross income from the business unless specifically excluded pursuant to section 39 of the ITA.

PROPERTY DEVELOPMENT COSTS

All direct expenses and outgoings attributable to development activities are to be capitalised as development expenditure which would be accorded a revenue deduction based on the project's percentage of completion recognised in a particular year of assessment.

Property Development Costs would include:

(i) infrastructure costs such as drainage, inner roads, reservoir and oxidation pond that add value to the project;

(ii) interest paid or payable on loans taken to finance the purchase of land or development works;

(iii) expenses incurred prior to the date of commencement of the project such as cost of land, survey fees, soil investigation expenses, architect fees, design and technical fees and cost of construction materials; and

(iv) proportion of common infrastructure costs.

ALLOCATION OF LAND COST

The Ruling provides that where a development project consists of more than one phase with different types of properties, the land cost for each phase of the project has to be apportioned based on land acreage.

ALLOCATION OF COMMON INFRASTRUCTURE COST

Contrary to the stringent rule imposed on the allocation of land cost, the IRB allows common infrastructure cost to be allocated either using the acreage method, relative sales value method or any other method that is acceptable by the DGIR.

FEES PAID FOR SOLICITING PROJECTS

The deductibility of such fees would depend on its purpose, nature and the circumstances under which the payment arises. Such fees would not qualify for deduction where the services provided by the payee involve no more than securing the project. However, if the payee after securing the project is actively involved in the management and

running of the project, then the fees may qualify as a commission or management fee that is deductible as part of the developer's administration expenses.

WARRANTY AND DEFECT LIABILITY EXPENSES

Warranty and defect liability expenses incurred by a property developer are allowable deductions against the income for the basis period or may be carried forward to the following basis periods. However, if the developer has insufficient or no gross income in the basis period or the following basis periods to take advantage of this deduction, then the developer may either:

(i) elect to have the defect liability expenses allowed as a deduction against the gross income from the same project for the basis period or periods preceding the basis period in which the expenses are incurred until they are fully deducted; or
(ii) not to make such an election, in which event the expenses will be allowed as a deduction against the aggregate gross income from the developer's other projects for the basis period or any following basis periods, as the case may be, and thereafter against other sources of income of the developer.

LIQUIDATED AND ASCERTAINED DAMAGES ("LAD") AND STRATA TITLE EXPENSES

Provisions for LAD as well as strata title expenses are not tax deductible until and unless such expenses have in fact materialised.

The Ruling nevertheless provides that a developer who:

(i) develops only one project/phase;
(ii) has sold all the units in that project/phase;
(iii) goes into liquidation upon completion of the project/phase; and
(iv) has insufficient or no income from the project to offset the LAD and/or strata title expenses, may carry back such expenses to be deducted against the gross income from the same project for the basis period or periods preceding the period in which the expenses are incurred.

LEGAL AND PROFESSIONAL FEES

Legal and other professional fees that are allowed to be deducted against gross income according to the Ruling include:

(i) valuation fees paid at the time of purchase by the property developer;
(ii) legal fees paid for transfer of land titles, sub-division and conversion of land;
(iii) compensation for eviction of squatters from the land;
(iv) cost incurred in arranging end-financing facilities for purchasers.

Legal and other professional fees such as stamping, filing and fees incurred in connection with the arrangement of loans for the benefit of the property developer, including bridging loans, are not allowable deductions pursuant to section 39 of the ITA.

MARKETING AND PROMOTIONAL EXPENSES

Marketing expenses in any form of advertisements (media, billboards, brochures, etc) as well as promotional expenses such as free legal fees, free cabinets or free air-conditioners, provided they are wholly related to the sales of the development, are allowable deductions.

GUARANTEE FEES

The Ruling provides that guarantee fees paid to a guarantor in respect of a loan or credit facility is not a deductible expense.

GENERAL ADMINISTRATIVE EXPENSES

General administrative expenses such as audit fees and bank charges are deductible against gross income provided they satisfy the wholly and exclusively incurred in the production of income test.

CONCLUSION

It is hoped that readers have gained some insights into the rules under which the property development industry in Malaysia is taxed. It should be remembered that although the Ruling serves as a useful guide as to the manner in which the income derived from a property development is to be taxed, the Ruling nevertheless only reflects the IRB's views and is not binding on the courts.

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ENFORCING DAB DECISIONS UNDER THE FIDIC 1999 RED BOOK

By Gordon Smith (Partner) and Glen Rosen (Associate), Kennedys, Singapore

INTRODUCTION

This case summary discusses the recent decision of the Singapore Court of Appeal in CRW Joint Operation v PT Perusahaan Gas Negara (Persero) TBK [2011] SGCA 33, which expands upon the concept of a 'Final Partial Award' published by a tribunal to enforce a Dispute Adjudication Board (DAB) decision under sub-cl 20.6 of the Federation Internationale de Ingenieurs Conseils (FIDIC) Conditions of Contract for Construction (1st Edition, 1999) (1999 Red Book). This is the first judicial case in which this issue is considered.

The Court of Appeal upheld the High Court's decision to set aside a final award issued by the Majority Members in the ICC International Court of Arbitration Case No 16122/CYK under the Singapore International Arbitration Act (the IAA). The Court of Appeal dismissed CRW's application on the basis that the Majority Members had breached their jurisdiction and breached the rules of natural justice by failing to review the merits of the DAB's decision and accord PGN the opportunity to defend its position.

FACTS

PT Perusahaan Gas Negara (Persero) TBK (PGN) entered into a contract with CRW Joint Operation (CRW) to design, procure, install, test and pre-commission an optical fibre cable in Indonesia (the Contract). The Contract adopted the General Conditions of the 1999 Red Book.

A dispute arose between the parties regarding 13 different variation proposals issued by CRW to PGN. In accordance with the procedure set out in sub-cl 20.4 of the Contract, the dispute was referred to a DAB. The DAB issued a decision in favour of CRW for the sum of US$17,298,834.57.

In accordance with the procedure set out in the Contract PGN issued a notice of dissatisfaction (NOD) alleging the amount awarded by the DAB was excessive. On 13 February 2008 CRW filed a request for arbitration pursuant to sub-cl 20.6 of the Contract with the ICC, with the seat of the arbitration being Singapore. The purpose of CRW's request was to give 'prompt effect to the adjudicator's decision'.

PGN filed its response submitting that the DAB's decision was not yet final and binding as PGN had issued a NOD in accordance with terms of the Contract. PGN further submitted that the DAB's decision ought to be re-opened and that CRW's request for prompt payment of the amount of the DAB's decision should be rejected.

ICC Arbitration

CRW referred to arbitration not the underlying dispute which formed the basis of the DAB decision but rather a 'Second Dispute' as to whether PGN was obliged to comply with the DAB decision and pay the sum of US$17,298,834.57.

Following arbitration proceedings in Singapore, the Arbitral Tribunal issued a Final Award in favour of CRW entitling CRW to immediate payment of the sum of US$17,298,834.57. In reaching this conclusion the Arbitral Tribunal found that PGN was not entitled in the arbitration to request the Arbitral Tribunal to open up, review and revise the DAB's decision.

Singapore High Court

CRW sought to enforce the Final Award in Singapore and on 7 January 2010 an order giving effect

to CRW's application was made (Enforcement Order). PGN filed a separate application in the High Court in Singapore to have the Enforcement Order and Final Award set aside.

The High Court set aside the Final Award under the IAA on the basis:

(a) the Majority Members had issued a final award on the Second Dispute even though the dispute had not been referred to the DAB in accordance with the provisions set out in the Contract; and
(b) even if the Second Dispute was referable to arbitration, the Contract did not entitle the Arbitral Tribunal to make the DAB's decision final without first hearing the parties on the merits of the decision.

In effect the High Court's decision meant that where a contractor such as CRW was seeking to enforce a DAB decision for payment it needed to:

(a) first refer back to the DAB the dispute as to whether payment is owing, which is a timely process; and
(b) frame the Request for Arbitration so that the contractor is challenging the underlying disputes, which the DAB has already made a decision on and not solely whether immediate payment is owing.

COURT OF APPEAL

CRW appealed the High Court decision and on 13 July 2011 the Court of Appeal dismissed CRW's appeal.

In reaching the conclusion that CRW's appeal should be dismissed the Court of Appeal held that the scope of the Arbitral Tribunal's jurisdiction was defined by sub-cl 20.6 of the Contract and the terms of reference (TOR) of the arbitration. The Court of Appeal held that sub-cl 20.6 of the Contract and TOR made it clear that the Arbitral Tribunal was to decide not only whether CRW was entitled to immediate payment but also additional issues of fact or law which the Arbitral Tribunal deemed necessary to decide.

Sub-cl 20.6 of the Contract provides:
'Unless settled amicably, any dispute in respect of which the DAB's decision (if any) has not become final and binding shall be finally settled by international arbitration…

The arbitrator(s) shall have full power to open up, review and revise any certificate, determination, instruction, opinion or valuation of the Engineer and decision of the DAB relevant to the dispute…

Neither Party shall be limited in the proceedings before the arbitrator(s) to the evidence or arguments previously put before the DAB to obtain its decision, or to the reasons for dissatisfaction given in its notice of dissatisfaction'.

The Court of Appeal held that it was quite plain that a reference to arbitration under sub-cl 20.6 of the Contract in respect of a binding but non final DAB decision is clearly in the form of a rehearing so that the entirety of the parties' disputes can be resolved afresh, and therefore the Majority Members had not issued its Final Award in accordance with sub-cl 20.6 of the Contract.

In coming to this conclusion the Court of Appeal referred to the Dispute Board Federation September 2010 newsletter noting the ICC decision (in which Kennedys acted for the successful party), where the tribunal made it clear that whilst the DAB's decision was enforceable under a partial award the subject matter of the DAB decision could be opened up, reviewed and revised by the arbitral tribunal in the same arbitration in accordance with sub-cl 20.6 of the 1999 Red Book.

In reaching the conclusion that the Final Award should be set aside, the Court of Appeal noted that this issue turned on whether the Majority Members had the power to issue the Final Award without opening up, reviewing and revising the Adjudicator's decision. The Court of Appeal held that the Majority Members had exceeded their jurisdiction (contrary to Art 34(2)(iii) of the Model Law) by failing to consider the merits of the DAB's decision prior to the making of the Final Award.

The Court of Appeal noted that they found it difficult to understand why the Majority Member ignored the clear language of sub-cl 20.6 of the Contract to "finally settle" the dispute between the parties and instead abruptly enforce the DAB's decision without reviewing the merits of that decision.
The Court of Appeal noted the Majority Members should have made an interim award in favour of the CRW for the amount assessed by the DAB and then proceeded to hear the parties' substantive dispute afresh before making a final award. Accordingly, the Court of Appeal held that the Final Award was not issued in accordance with sub-cl 20.6 of the Contract.

The Court of Appeal also held that the Majority Members had breached the rules of natural justice (contrary to s24(b) of the IAA) by failing to allow PGN an opportunity to present its case on the DAB decision. In addition, the Court of Appeal held that PGN suffered real prejudice as a result.

IMPLICATIONS

This decision will have a number of implications for contractors and tribunals alike in which DAB decisions under the 1999 Red Book (and indeed the 1999 Yellow and Silver Book equivalents) are referred to arbitration:

(a) from a contractor's perspective if it wishes to enforce payment of a DAB decision it needs to refer the DAB's underlying decision itself to arbitration, in the course of which it could seek an interim award for payment of the DAB's decision. Like CRW, this may not be a contractor's first inclination in circumstances where the DAB's decision is in its favour; and
(b) from the Tribunal's perspective, if it intends to issue an award for payment of the DAB decision, it needs to ensure that it is a final interim award pending its determination of a final interim or partial award on the underlying issues.

One issue the Court of Appeal did not address was the High Court's view that a dispute between the parties concerning immediate payment of the DAB decision (which will always be disputed by the employer) must first be referred to the DAB prior to the contractor seeking a final interim award from the Tribunal. With respect, we do not consider this to be the intended purpose of sub-cl 20.4. If a DAB has given its decision, it has clearly done so on the understanding that "The Decision shall be binding on both Parties who shall promptly give effect to it…" (sub-cl 20.4), and it would be otiose for the contractor to spend a further 112 days under sub-cl 20.4 to go through a procedure of having the DAB confirm this.

Importantly, for the guidance of readers, the authors have been involved in the enforcement by arbitration of numerous DAB decisions in which a referral back to the DAB was not deemed to be necessary for the effective enforcement of a DAB decision by an arbitral tribunal. One such case was referred to by the Court of Appeal.

The reader should note that sub-cl 20.9 of the FIDIC Conditions of Contract for Design, Build and Operate Projects (1st ed, 2008) (the Gold Book) addresses this situation by providing for a situation whereby a failure to comply with a DAB decision can itself be referred to arbitration rather than the underlying dispute. Sub-cl 20.9 states:

'In the event that a Party fails to comply with any decision of the DAB, whether binding or final and binding, then the other Party may, without prejudice to any other rights it may have, refer the failure itself to arbitration under Sub-Clause 20.8 [Arbitration] for summary or other expedited relief, as may be appropriate…'

It is the authors' view that there is already a settled practice at the level of international arbitration where DAB decisions can be enforced directly by an arbitral tribunal, at least on a temporary basis pending a Final Award. It is significant that the Court of Appeal shares this view (to our knowledge being the first common law Court to rule on this), at least with respect to binding but not final DAB decisions rendered under the 1999 FIDIC Conditions of Contract.

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SINGAPORE AND THE PREVENTION RULE – A STEP TOO FAR?

The prevention rule is concerned with an act or omission of the employer which prevents the completion of the works, and which does not give rise to a contractual entitlement to the contractor for an extension of time. Such an act or omission has two key effects.

Firstly, time is set at large – the contractor's obligation to complete by the contractual date is replaced with an obligation to complete within a reasonable period of time. The employer would have to show that the works were not completed within a reasonable time, in order to sustain a claim for delay in completion.

Secondly, the employer is disentitled from claiming liquidated damages for delay. The disapplication of the liquidated damages clause is itself traditionally premised on the replacement of the obligation to complete by the contractually stipulated date, with an obligation to complete the works within a reasonable time. The corollary is that there is no contract date from which liquidated damages can run[1]. Accordingly, not only does the employer have to prove that the works were not completed within a reasonable time. The employer would also have to prove the loss flowing from delay, subject to the usual limits on recovery.

THE WILD CARD

The 'wild card' nature of the prevention rule is highlighted by three ancillary rules. Firstly, the law appears to be that the liquidated damages provision would, notwithstanding its disapplication, continue to operate as a limitation on liability[2]. Thus, once the prevention rule bites, not only does the employer have to prove its loss; its recoverability in respect of that loss is capped. Secondly, as recently recognised by Jackson J in Multiplex Constructions (UK) v Honeywell Control Systems[3], actions by the employer which are perfectly legitimate under a construction contract may still be characterised as acts of prevention (for example, a variation order issued pursuant to the terms of the contract). Thirdly, on the authority of Peak Construction v McKinney Foundations[4], even if only one of two separate and distinct periods of delay with two separate causes is the result of an act of prevention not catered for in the contract, the prevention rule would apply.

The prevention rule has its roots in the 19th century view of clauses providing for sums payable upon breach as weapons of oppression. Since then, the courts have struggled in reconciling the rule with commercial sense. Thus, in Rapid Building v Ealing Housing Association[5], Lloyd LJ remarked that he "was somewhat startled to be told… that if any part of the delay was caused by the employer, no matter how slight, then the liquidated damages clause in the contract… becomes inoperative". Lloyd LJ went on to state that he could "well understand how that

[1] Hudson's Building and Engineering Contracts (2010, 12th Edn), at 6-028
[2] Elsley v Collins Insurance Agencies Ltd (1978) 2 SCR 1
[3] [2007] 1 BLR 195
[4] [1976] 1 BLR 111
[5] (1984) 29 BLR 5

must necessarily be so in a case in which the delay is indivisible, and there is a dispute as to the extent of the employer's responsibility for that delay." Ironically, in the recent English High Court decision of Adyard Shipping[6], it was considered that where there are two concurrent causes on delay, one of which was due to the fault of the employer and not covered by the contractor, the principle would not in fact be triggered because the contractor could not show that the employer's conduct made it impossible for him to complete within the stipulated time.

Lim Chin San and the causal analysis

In the recent decision of Lim Chin San Contractors v LW Infrastructure Ptd Ltd[7], the Singapore High Court had the opportunity to consider the prevention rule. The limited question before the court was phrased in the following terms:

"where there were acts of prevention which caused delay in the progress of the works and which were not extendable [sic] under the sub-contract, whether it was necessary for [the contractor] to have been prevented from completing the works by a prescribed date in order for time to be set at large."

The Singapore High Court decided that it was necessary for the act of prevention to delay the date of completion of the works. What is perhaps of greater significance is that the reasoning of the High Court suggests that in order for the prevention rule to bite the contractor must show that the contractual date for completion of the works is not achievable as a result of the purported act or omission of the employer. Further, the principles to be applied in determining the sufficiency of the causal connection would appear to be analogous to those applicable to a contractor's claim for a reasonable period of extension based on a contractual entitlement. Indeed, the Court expressly linked the question of proof of prevention of completion to issues of float and to critical path analysis. In other words, the decision suggests that it is not sufficient for the contractor to show that the event had an impact on the critical path on its own programme. Instead, the contractor must go the whole hog, and show, on the basis of a full programming analysis, that the prevention caused completion to be delayed beyond the contractual date for completion.

NEW LAW OR OLD?

It is perhaps beyond dispute that an act of the employer which does not actually affect the completion of the works would not satisfy the requirements of the prevention rule[8]. However, the law has never been entirely clear on what precisely it is that the contractor needs to prove in order to invoke the operation of the rule. Many of the early cases in which the rule was developed were decided on pleas of demurrer.

It is this commentator's view that the true test is whether the act or omission of the employer affects

[6] Adyard Abu Dhabi v SD Marine Services [2011] EWHC 848 (Comm)
[7] [2011] SGHC 162
[8] A good example is Baskett v Bendigo Gold-Dredging Co Ltd (1902) 21 NZLR 166

the contractor's own critical path. Cases such as Fernbrook Trading v Taggart[9], are reconcilable with the views that it is sufficient for the contractor to show that the 'prevention' has delayed a critical path event, and unnecessary to show that the actual completion was delayed. Indeed, in Peak Construction v McKinney[10] itself, the reasoning of Salmon LJ suggests that the onus falls on an employer to show that once it is accepted that delay to completion is a likely result of the alleged act of prevention, the onus falls on the employer to show that the act of prevention did not delay actual completion (as opposed to contractual completion) of the works. Recently, in Jerram Falkus Construction Ltd v Fenice Investments Inc, it was stated that in order for the prevention principle to apply, "the contractor must be able to demonstrate that the employer's acts or omissions have prevented the contractor from achieving an earlier completion date… "[11].

Take the following hypothetical example. Assume the contractor's programme provides for a float of 1 month. An employer's act of prevention, not covered by a clause in the contract, results in a delay, to a critical path event, of 10 days. A contractor's time risk event results in a separate critical delay of 25 days. The decision in Lim Chin San would appear to suggest that the contractor would not be able to argue that time was set at large by these events, as, given the period of float, the contractor would not be able to show that the act of prevention delayed the contractual date for completion. This would have the effect of denying the contractor the float time to hedge against his own delays.

A question of principle

In any event, given that a contractor is generally master of his own programme, and given that the prevention principle is premised on there being no contractual mechanism for the allocation of the time risk of the act or omission of the employer, it is submitted that the better (albeit strained) interpretation of Lim Chin San is that the case is premised on the fact of the contractor not having passed the initial hurdle of showing that the alleged act of prevention has affected its critical path.

The prevention rule is based on two principles. The first principle is that a party ought not to be entitled to take advantage of its own wrong. The second principle, the product of 19th century thinking, is that clauses providing for sums payable on breach are in terrorem and ought to be viewed with disfavour.

The tightening of the scope of the prevention rule in Lim Chin San is perhaps understandable, given the wild card nature of the prevention rule. However, the approach suggested by Lim Chin San would make inroads into the first principle underlying the rule. This, it is submitted, would be unjustified. The principle that a party ought not to be entitled to take advantage of its own wrong is and ought to be a pillar of commercial justice.

It is the second principle that raises the problem. The traditional circumspection of the law in its view of sums payable upon breach is outdated. Provisions for liquidated damages are a valuable commercial tool, a lifeline to commercial parties managing risk in the shipwreck of the common law on damages. In any event, the Dunlop Pneumatic test (and, in Malaysia, ss. 75 of the Contracts Act), provides more than adequate protection against the potential injustice of liquidated damages clauses.

Given that the common law is beginning to recognise the commercial sense even in reducing the scope of the penalty jurisdiction (see for example AG Hong Kong v Philips[12]), perhaps it is time to recognise that an act of prevention ought not to result in a disapplication of the liquidated damages clause, but rather, that any delay attributable to an act of prevention ought to result in an extension of the contractual date, with any evidential uncertainty in relation to the attribution of the delay being resolved in favour of the contractor, all else being equal.

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[9] [1979] 1 NZLR 556
[10] [1976] 1 BLR 111, 119-120
[11] [2011] EWHC 1935 (TCC), at [52].
[12] [1993] 61 BLR 41

THE OPERATION OF DISPUTE CLAUSES: LITIGATION IS NOT THE FACTORY SETTING

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INTRODUCTION

It is common in construction contracts for there to be detailed clauses as to the giving of notice, and the resolution of disputes through a serious of procedures, escalating in the level of formality.

Such "step" clauses may work, like Scott v Avery clauses, to preclude court litigation until there is full compliance with the clause. It is sometimes thought that the last resort, once all the steps in the step clause have been completed, is court litigation. However, the issue will turn on the proper construction of the clause. Court litigation is not necessarily the default factory setting for such clauses. Just as arbitration is an entirely appropriate, final self-contained method of resolving disputes, including construction disputes, other methods may be set by the parties and the courts will hold the parties to their bargain.

One method chosen by the parties is expert determination.

EXPERT DETERMINATION

Expert determination is an informal, private fact method of resolving disputes. There is, however, no legislative super-structure supporting expert determination, unlike arbitration. Hence, the conduct and effect of expert determination is ultimately a matter of contract. An expert determination clause which states that it is final and binding on the parties can only be attacked on limited grounds. This position has recently been reaffirmed in Lipman Pty Ltd v Emergency Services Superannuation Board [2010] NSWSCA 710, a decision of the Court of Appeal in New South Wales.

THE LIPMAN CASE - FACTS

In that case, by agreement dated 19 March 2002, Lipman Pty Ltd (the plaintiff / principal) entered into a construction contract with the Emergency Services Superannuation Board (defendant / contractor) in relation to the redevelopment of a shopping centre at Fairfield near Sydney. The agreement contained clause 42 entitled Dispute Resolution. Relevantly, clauses 42.10 and 42.11 were in the following terms:

"42.10 Determination by Expert
The determination of the expert:
(a) must be in writing; and
(b) …is final and binding unless a party gives notice of appeal to the other party within 21 days of the determination; and
(c) is to be given effect to by the parties unless and until it is reversed, overturned or otherwise changed under the procedure in the following clauses.

42.11 Executive Negotiation
If a notice of appeal is given under clause 42.10, the dispute is to be referred to the persons described in Annexure Part A who must:
(a) Meet and undertake genuine and good faith negotiations with a view to resolving the dispute; and
(b) If they cannot resolve the dispute or difference, endeavour to agree upon a procedure to resolve the dispute."

The plaintiff made a number of claims against the defendant, several of which the defendant disputed. By agreement dated 14 March 2005, the parties appointed Messrs Norman Fisher and P Callaghan SC to resolve their dispute as experts under clause 42. By determination dated 7 December 2005, the experts determined that the plaintiff owed the defendant a small amount.

Questions may arise as to whether a step dispute clause, ending in expert determination is an ouster of the court's jurisdiction and are thus void.

On 13 January 2006, the plaintiff served a document titled "Notice of Appeal of Determination of Expert Pursuant to Clause 42.10" on the defendant, the defendant having previously agreed to extend the time for service. During the next 5 months, the parties met to resolve the dispute in accordance with the procedure contained in clause 42.11 of the agreement. The parties were unable to resolve their disagreement. Three and a half years later on 11 December 2009, the plaintiff commenced proceedings against the defendant in the amount of $1,021,782.

The trial judge stated that the sole issue for determination was whether, on the proper construction of clause 42 (in particular, clauses 42.10 and 42.11), the expert determination was final and binding and if not, whether the plaintiff was free to pursue its claims against the defendant The plaintiff argued that an expert determination under clause 42.10 was final and binding on the parties only where a party does not give a notice of appeal.

The trial judge rejected the plaintiff's argument and held that the:

"plain and unambiguous words of clause 42.10(c) require the expert determination to be given effect to unless and until it is reversed, overturned or otherwise changed under the procedure under clause 42.11. That procedure has done whatever work it could do in the present circumstances and the expert determination has not be reversed, overturned or otherwise changed. It follows that it remains binding."

The plaintiff appealed arguing that the trial judge did not give proper weight to the phrase commencing with the word "unless" in clause 42.10. The plaintiff argued that the expert determination was not final and binding should a notice of appeal be filed, which it did.

President Allsop, with whom Young JA and Tobias AJA concurred, agreed with the trial judge.

President Allsop stated that the trial judge had approached the construction of the dispute resolution clause by reference to a liberal approach expressed in Francis Travel Marketing Pty Ltd v Virgin Atlantic Airways Ltd (1996) 39 NSWLR 160 and Fiona Trust & Holding Corporation v Privalov [2007] UKHL 40. His Honour stated that to adopt the liberal approach was to:

"give effect to a coherent business purpose through an assumption commercial courts around the world will make that parties are unlikely to have intended multiple venues or occasions for the resolution of their disputes unless they say so." (Lipman v Pty Ltd v Emergency Services Superannuation Board [2011] NSWCA 163 at [8])

This meant that clause 42.10 should be given its full effect, subject to it not being final and binding if the parties were able to give "substance and effect" to their good faith negotiations as per clause 42.11. So, in effect, if the parties could not settle on terms after the determination, then the determination prevailed.

The Court adopted the reasoning in Francis Travel, although the case concerned an arbitration clause. In Francis Travel, the Court was asked to consider the meaning and effect of Article 19 of an agency agreement. Article 19 stated relevantly that any "dispute or difference arising out of this agreement shall be referred to the arbitration in London of a single arbitrator to be agreed by the parties

…." Gleeson CJ, with whom Meagher Sheller JJA agreed held that:

"When the parties to a commercial contract agree, at the time of making the contract, and before any disputes have yet arisen, to refer to arbitration any dispute or difference arising out of the agreement, their agreement should not be construed narrowly. They are unlikely to have intended that different disputes should be resolved before different tribunals, or that the appropriate tribunal should be determined by fine shades of difference in the legal character of individual issues, or by the ingenuity of lawyers in developing points of argument." (Francis Travel Marketing Pty Ltd v Virgin Atlantic Airways Ltd (1996) 39 NSWLR 160, 165 [D])

Lipman continues the recent trend towards Courts giving effect to the parties' bargain, and to uphold dispute clauses, despite unsettling court litigation as the default process. (See also Straits Exploration (Australia) Pty Ltd and Another v Murchison United NL and Another (2005) 31. WLR 187 at 193 [15])

CONCLUSION

Questions may arise as to whether a step dispute clause, ending in expert determination, is an ouster of the court's jurisdiction and are thus void. The better, and modern view, is that such clauses are valid. Wheeler JA in Straits Exploration stated:

"There is increasingly, as a matter of commercial practice, a tendency of parties to provide for the determination of some or all disputes by reference to an expert. There are a number of reasons for that course, including informality and speed; suitability of some types of disputes for determination by persons with particular expertise; privacy; and a desire to resolve disputes in a way which may be seen as reasonably consistent with the maintenance of ongoing commercial relationships. The law has long recognised that those are proper considerations to which the Court should give appropriate weight, and that it is desirable therefore that parties who make such a bargain should be kept to it. The tendency of recent authority is clearly in favour of construing such contracts, where possible, in a way that will enable expert determination clauses to work as the parties appear to have intended, and to be relatively slow to declare such provisions void either for uncertainty or as an attempt to oust the jurisdiction of the court."

So, it will become increasingly difficult for parties who have accepted a particular method for resolving their disputes to escape the consequences from that choice by recourse to ouster doctrines or conceptions of the default position. We must lie in the beds we make.

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FOURTH INTERNATIONAL CONSTRUCTION LAW CONFERENCE

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Melbourne 2012 May 6 - 8

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The Melbourne conference is the fourth in the series of successful international conferences organised by Societies of Construction Law.

The organisers of the Melbourne conference have planned a stimulating programme that will maintain the high standard of previous conferences, and anticipate it will attract delegates from around the world to "down under". The keynote speaker will be the Right Honourable Rupert Jackson, Lord Justice of Appeal England and Wales.

The conference theme: **"Global challenges, shared solutions"** encapsulates the idea that the issues in construction law that transcend boundaries and jurisdictions commonly have similar solutions, despite the formal and informal differences in the law. The papers from eminent practitioners from around the world address a range of common issues in construction law from a civil law, as well as a common law perspective. The conference program also includes an academic forum for construction law teachers and researchers, and country reports from Societies of Construction Law.

The conference will be preceded by a cocktail party at a unique Melbourne venue. The conference sessions will be held at the Sofitel Hotel at the top end of Collins Street, adjacent to Melbourne's extensive parks and its iconic sporting venues.

The conference dinner will be held at the well known Melbourne Cricket Ground, and delegates have the option of a pre-dinner tour of the MCG and the National Sports Museum. Following the conference, there will be a full day Mornington Peninsula winery tour, visiting two vineyards and the stunning Port Phillip Estate for lunch.

Conference delegates will have a unique opportunity to attend two other functions of considerable interest to construction law practitioners:

- A construction law seminar in Melbourne on Sunday 6 May, jointly hosted by the American College of Construction Lawyers and the Canadian College of Construction Lawyers. Details can be found at www.constructionlaw2012.com.
- The 12th Annual International Dispute Resolution Board Foundation Conference in Sydney from 4 – 5 May: **The Benefits of Dispute Boards to Major Projects** [www.drba.com.au/conference/].

Further details of the conference program, speakers and social activities can be found on the conference website:

www.constructionlaw2012.com

Hosted by

Society of Construction Law Australia

Society of Construction Law New Zealand

Supporting Organisations

Society of Construction Law Malaysia

Canadian College of Construction Lawyers Inc. / Le Collège Canadien des Avocats en droit de la construction inc.

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By Mike Allen
Global Head of Contract Solutions
EC Harris

CONSTRUCTION DISPUTES ON THE RISE

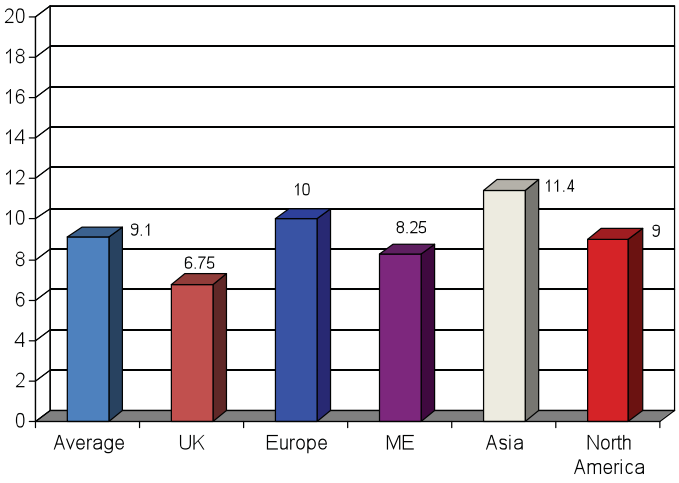
Resolving major contract disputes represents an extremely expensive, time consuming and often unnecessary distraction for clients and contractors alike, so with our recent EC Harris 'Global Construction Disputes Report' showing that the number of construction disputes is increasing, there is cause for concern.

Overall, the report found that the Middle East and North America had both seen an increase in the number of disputes during 2010 when compared to 2009 with Europe the only region to see a fall in disputes. The number of disputes in Asia was similar to the previous year.

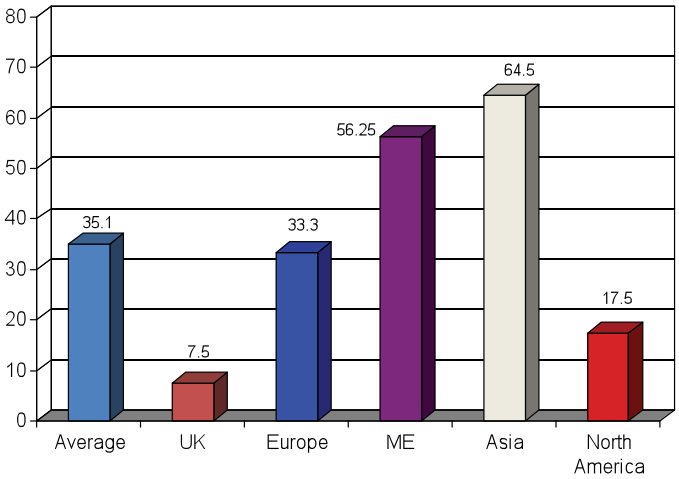
In a year that saw several high profile, major value disputes in the Middle East and Asia, we found that disputes were lasting, on average, 9.1 months from inception to resolution. Disputes in Asia, however, continued the longest up to 11.4 months, UK experienced the shortest period at 6.75 months.

Overall, the average value of disputes handled by the EC Harris team was US$35.1m in 2010, with the highest average value being in Asia (US$64.5m) followed by the Middle East (US$56.25m). The highest value dispute handled by EC Harris during the course of 2010 was for US$200m in Asia, albeit EC Harris did work on a major dispute in the Middle East where the disputed value was higher but undisclosed.

GLOBAL COMPARISON: AVERAGE LENGTH OF DISPUTES IN MONTHS



GLOBAL COMPARISON: AVERAGE VALUE OF DISPUTES IN US$MILLION



COMMON CAUSES

The research found that a failure to properly administer the contract was the most common cause of construction dispute in 2010, demonstrating poor governance during the course of the construction project. The top five causes of dispute in construction projects during 2010 were:

1. A failure to properly administer the contract
2. Ambiguities in the contract document
3. A failure to make interim awards on extensions of time and monetary relief
4. Unrealistic risk allocation between employers and contractors
5. Change imposed by the employer

JOINT VENTURES

Where a Joint Venture was in place to deliver a construction project, our research found that nearly a third (31%) of these JVs resulted in dispute. In these JV disputes, the conduct of the Project Manager or Engineer was found to be at the heart of the dispute on more than half (53%) of occasions with a lack of understanding of contract procedure and a partiality to the employer's interests the two biggest PM or Engineer mistakes.

DISPUTE RESOLUTION

When resolving their clients' disputes, we also tracked the most common means of dispute resolution. Overall, arbitration was the most popular method, followed by party-to-party negotiation and contract or ad hoc adjudication.

WHAT DOES THIS RESEARCH TELL US?

There is no doubting that one must consider the context of this data. Regional variances on the length and value of the disputes are related to the size, complexity and number of construction projects that are being undertaken within the various regions.

The common causes mentioned above suggest that whilst the contracts themselves contain inter-related time management and notification provisions, they are only as good as the operation of those respective provisions. This cannot only affect the timely capture of relevant data, but can also severely influence and affect the project cash flow, sub-contractors and also the morale and relationships between the parties and the Engineer or Project Manager.

Directly related to this is a failure to provide interim extensions of time and monetary relief. This issue would appear to have a number of features that would be influenced by the quality and standard of substantiation provided to support the application, the level and experience of the Engineer or PM (who is administering the Contract), the impartiality of the Engineer or PM, the levels of authority provided to the Engineer or PM and also the dispute resolution mechanism, which will be explored in more detail below; and

Incorrect contract selection also appears to be a common feature relating to the causes of disputes. The allocation of risk between parties, the way that constraints are incorporated and also the pricing mechanism, all need to be adapted for each project. The contract itself needs to be fitted around the project constraints and characteristics (and not the reverse).

A related factor to the length of the dispute is the method of alternative dispute resolution that is adopted within each region and also the approach or type of contracting arrangement.

It is interesting to note the various collaborative contracting initiatives where target cost contracting, using ad-hoc or NEC forms are now being applied on a limited basis in the Middle East and Asia regions.

Adjudication in the UK features highly as the method of dispute resolution and recent statistics show that most adjudication decisions are accepted by the parties without recourse to the courts for a rehearing of the matter. There has been a slow down in the number of decisions where enforcement is being challenged through the courts. This demonstrates the success of the process and explains why disputes within the UK are generally resolved more swiftly than elsewhere in the world. In addition, parties appear to like the fact that the adjudication process is conducted privately and maintains confidentiality.

Adjudication does feature in Asia, but on a limited basis contractually in Hong Kong and at a statutory level in Singapore.

In the Middle East and Asia, arbitration dominates the dispute resolution process. Dubai, Hong Kong and Singapore all feature highly as being hubs for top international arbitration, which has no doubt been influenced by the endorsement of the respective governments as well as the adoption of the New York Convention. The case loads for each of the centres has shown an increase, and an interesting feature is the growth of CIETAC arbitrations in China, and the related cross border relations with Hong Kong.

With a vibrant construction industry and multi cultural contracting

relationships, the option of using arbitration as a method of dispute resolution is appealing. This allows parties from different jurisdictions to opt for a neutral country to host and resolve their dispute.

In addressing most of the main causes of disputes, applying the right skills at the right time and being targeted on delivering what the employer needs and delivering that in accordance with the contract, would go a long way to reduce the nature and extent of any dispute. An early involvement by independent specialist consultants focused on business outcomes, can significantly assist in achieving this.

EC Harris's specialist Contract Solutions team helps clients avoid, mitigate and resolve disputes. The team is based around the globe and encompasses one of the industry's largest pool of procurement, contract, risk management and also quantum, delay, project management, defects and building surveying experts. The Contract Solutions team provides procurement, contract and dispute avoidance and management strategies, management expertise and expert witness services. This is delivered through a blend of technical expertise, commercialism, sector insight and the use of live project data, combined with a multi disciplined and professional focus.

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ABOUT THE SOCIETY OF CONSTRUCTION LAW, MALAYSIA

The Society of Construction Law, Malaysia (previously known as the Society of Construction Law – Kuala Lumpur & Selangor) was formed in 2004 with the objective of promoting education, study and research in the field of construction law and practice as well as related subjects including project management, risk management, arbitration, adjudication, mediation and other modes of alternative dispute resolution. The Society has organised and held various Seminars and Talks related to construction law, both at introductory and advanced levels.

The Society is autonomous but has strong links with similar societies around the world including the Society of Construction Law UK and in Singapore, Hong Kong, the Gulf States (UAE, Bahrain, Qatar), Australia, New Zeland, Mauritius, Caribbean and the European Society of Construction Law which consists of 17 national construction law societies in Europe.

Anyone who is interested and professionally involved in construction law is encouraged to apply to become a member of the Society. Membership is open to all sectors of the construction industry, for example, architects, engineers, surveyors, contractors, developers, lawyers, arbitrators and experts. Student pursuing engineering, construction and law courses are welcome to join the Society.

MALAYSIA