

Direct payment under CIPAA where main contractor is in liquidation

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Facts

BHL Builders Sdn Bhd (BHLB) appointed CT Indah Construction Sdn Bhd as the subcontractor in a construction project. The employer was BHL Gemilang Sdn Bhd.

CT Indah was owed progress payments of approximately RM9 million. It commenced an adjudication against BHLB and obtained a decision in its favour. When BHLB failed to comply with this decision, CT Indah commenced winding-up proceedings against it.

CT Indah concurrently made a written request for direct payment against the principal, BHL Gemilang, pursuant to Section 30(1) of the Construction Industry Payment and Adjudication Act 2012 (CIPAA). BHL Gemilang opposed the direct payment application primarily on the basis that:

- the adjudication decision had yet to be enforced (ie, registered) as a high court judgment under Section 28 of the CIPAA; and
- BHL Gemilang owed no money to BHLB.

In the course of the hearing of the direct payment application, the issue arose as to whether direct payment could be ordered against BHL Gemilang when winding-up proceedings were underway against BHLB. To avoid protracted arguments, CT Indah withdrew the winding-up proceedings against BHLB in the course of the hearing of the direct payment application. However, another creditor presented a winding-up petition on BHLB shortly thereafter. The issue therefore remained.

Section 30 of CIPAA

Section 30 of the CIPAA creates a statutory obligation for principals (the employer in the present case) to make the payment awarded in an adjudication decision to a subcontractor if the main contractor fails to do so, provided that the principal owes this amount or more to the main contractor.

Section 30 reads as follows:

30. Direct payment from principal

- 1. If a party against whom an adjudication decision was made fails to make payment of the adjudicated amount, the party who obtained the adjudication decision in his favour may make a written request for payment of the adjudicated amount direct from the principal of the party against whom the adjudication decision is made.*

2. Upon receipt of the written request under subsection (1), the principal shall serve a notice in writing on the party against whom the adjudication decision was made to show proof of payment and to state that direct payment would be made after the expiry of ten working days of the service of the notice.
3. In the absence of proof of payment requested under subsection (2), the principal shall pay the adjudicated amount to the party who obtained the adjudication decision in his favour.
4. The principal may recover the amount paid under subsection (3) as a debt or set off the same from any money due or payable by the principal to the party against whom the adjudication decision was made.
5. This section shall only be invoked if money is due or payable by the principal to the party against whom the adjudication decision was made at the time of the receipt of the request under subsection (1).

A Section 30 direct payment obligation is arguably triggered by the issuance of a written notice under Section 30(1). In the absence of proof of payment under Section 30(2) – and on the basis that monies are due or payable by the principal to the respondent in the adjudication (Section 30(5)) – the direct payment obligation arises.

High court decision

The high court dismissed the Section 30 direct payment obligation, mainly because this direct payment would be preferential towards CT Indah, given that a winding-up petition had already been presented on BHLB. The high court held that provisions of the Companies Act 1965 (which were applicable in this case) which prevent payment in preference of one creditor over another on the commencement of winding-up proceedings applied.

The high court proceeded on the premise that the monies for the direct payment were in fact monies due to BHLB. This was based on the court's interpretation of Section 30(5) of the CIPAA. Given that these were monies originally due to BHLB, they constituted its assets or property and should have been distributed in *pari passu* on its liquidation. BHLB (or its liquidator) is entitled to receive these sums from the principal, BHL Gemilang.

On this point, the high court preferred the approach in the Northern Ireland decision in *B Mullan & Sons (Contractors) Ltd v Ross* ((1996) 54 Con LR 163) over *Glow Heating Limited v The Eastern Health Board* ([1988] IR 110).

In *Glow Heating*, the main contractor was in liquidation. The nominated subcontractor (NSC) had sought a declaration that it was entitled to direct payment of retention monies held by the employer. There was a mandatory contractual provision in the main contract that obliged the employer to make direct payment to the NSC should the main contractor fail to prove that sums due to the NSC had been paid, on the architect's enquiry.

Given that the employer had a direct payment obligation towards the NSC (albeit under the main contract), the high court found that the liquidator of the main contractor had seized its property subject to the liabilities which affected it – in this case, the liability was the direct payment sum which the employer had to pay directly to the NSC. This was a contingent liability on the asset of the main contractor, and the liquidator had seized the assets of the main contractor subject to this liability.

In the present case, the high court found the *Glow Heating* approach to be inconsistent with the Companies Act 1965. In the court's view, those statutory provisions are specific to company liquidation and must prevail over Section 30 of the CIPAA. The high court preferred the *B Mullan* approach, which had distinguished itself from *Glow Heating* and found such direct payment to contravene trite liquidation principles against preferential payment.

Accordingly, the court dismissed CT Indah's direct payment application. CT Indah appealed.

Court of Appeal decision

In the Court of Appeal, it was argued, among other things, that there was no disagreement between the principles in *Glow Heating* and *B Mullan*. In *Glow Heating*, the direct payment had been permitted given the existence of a mandatory provision in the employer's contract with the main contractor for such direct payment. In *B Mullan*, there was no such obligation. Thus, the high court in *B Mullan* had refused direct payment.

On the facts of the present matter, there was a mandatory obligation – namely, a statutory one. Once Section 30 of the CIPAA was triggered, it was mandatory for BHL Gemilang to make direct payment. It was therefore argued that such a statutory obligation had to be given as much weight as the mandatory contractual obligation in *Glow Heating*. The liquidator had been required to seize BHLB's assets subject to the contingent liability of this direct payment.

The Court of Appeal unanimously allowed the appeal and issued a judgment against BHL Gemilang. In arriving at this decision, the Court of Appeal held that a statutory obligation to pay under Section 30(3) of the CIPAA is stronger than a contractual obligation, as BHL Gemilang was legally bound to pay the adjudicated sum to CT Indah in the absence of proof of payment by BHLB under Section 30(2). It was further ruled that Section 30 of the CIPAA creates an independent statutory obligation on BHL Gemilang to pay CT Indah, which existed in parallel with BHLB's obligation to pay CT Indah under the adjudication decision.

BHL Gemilang applied for leave to appeal to the Federal Court against the Court of Appeal's decision. As of 9 January 2020, this application was pending.

For further information on this topic please contact Foo Joon Liang at Gan Partnership by telephone (+603 2201 1130) or email (joonliang@ganlaw.my). The Gan Partnership website can be accessed at www.ganlaw.my.

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