

Section 30 of CIPAA: apex court maintains mandatory direct payment obligation against employer under receivership

08 September 2020 | Contributed by [Gan Partnership](#)

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Introduction

The direct payment made by an employer of a construction project to a subcontractor is a key feature of statutory adjudication in Malaysia. In *BHL Gemilang Sdn Bhd v CT Indah Construction Sdn Bhd*,⁽¹⁾ the apex court refused to disturb the Court of Appeal's landmark ruling which tests the efficacy of the direct payment provision under Section 30 of the Construction Industry Payment and Adjudication Act 2012 (CIPAA) in light of insolvency laws.

Facts

BHL Builders Sdn Bhd (BHLB), the main contractor of a construction project, appointed CT Indah Construction Sdn Bhd (CT Indah) as the subcontractor in the construction project. BHLB's employer was BHL Gemilang Sdn Bhd. CT Indah was owed progress payments of approximately RM9 million.

CT Indah commenced adjudication against BHLB pursuant to the CIPAA and obtained an adjudication decision in its favour. BHLB failed to comply with the adjudication decision. Winding-up proceedings were then presented against BHLB by CT Indah.

Concurrently, an application for direct payment pursuant to Section 30 of the CIPAA was taken out by CT Indah against BHL Gemilang. A written request for direct payment had been issued by CT Indah in accordance with Section 30(1) of the CIPAA. The direct payment application was opposed by BHL Gemilang, 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 that BHL Gemilang owed no sums to BHLB.

In the course of the direct payment application hearing, an issue arose on whether direct payment could be ordered against BHL Gemilang when winding-up proceedings against BHLB were already afoot. To avoid protracted arguments, CT Indah withdrew the winding-up proceedings against BHLB in the course of the direct payment application hearing. However, another creditor presented a winding-up petition on BHLB shortly thereafter; therefore, the issue remained. BHLB was wound up in August 2017, while receivers and managers were appointed over BHL Gemilang in September 2018.

Section 30 of CIPAA

Section 30 of the CIPAA creates a statutory obligation for a principal (the employer in this particular case) to make the payment awarded by an adjudication decision to a subcontractor in the event of the main contractor's failure to do so, provided that the principal owes such sums, or more, to the main contractor.

Section 30 reads as follows:

30. Direct payment from principal

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(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.** (Emphasis added.)

(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).

The triggering point of a Section 30 direct payment obligation is arguably 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 there are monies 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 to this case) which prevent payment in preference of one creditor over another upon the commencement of winding-up proceedings were in operation.

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 were assets or property of BHLB which had to be distributed in *pari passu* upon its liquidation. BHLB or its liquidator) was entitled to receive these sums from the principal, BHL Gemilang.

On this point, the high court preferred the approach in the Northern Irish decision of *B Mullan & Sons (Contractors) Ltd v Ross*⁽²⁾ over *Glow Heating Limited v The Eastern Health Board*.⁽³⁾

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 NSC should the main contractor fail to prove that sums due to NSC had been paid, upon the architect's enquiry.

Given that the employer had a direct payment obligation towards NSC (albeit under the main contract), the high court found that the liquidator of the main contractor had taken 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 NSC. This was a contingent liability on the main contractor's assets, and the liquidator had taken these assets subject to this liability.

However, in the present case, the High Court found the *Glow Heating* approach to be inconsistent with statutory provisions in the Companies Act 1965. In the high 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 differed from *Glow Heating* and found such direct payment to contravene trite liquidation principles against preferential payment.

Accordingly, CT Indah's direct payment application was dismissed. CT Indah appealed to the Court of Appeal.

Court of Appeal decision

The Court of Appeal held that BHL Gemilang's obligation to make direct payment was an independent statutory obligation under Section 30 of the CIPAA, which is stronger than a contractual obligation. In the absence of proof of payment by BHLB as requested by CT Indah under Section 30(2), BHL Gemilang's direct payment obligation became mandatory.

The next question was whether the mandatory nature of the direct payment obligation was affected by BHLB's liquidation or BHL Gemilang's receivership. The Court of Appeal rejected BHL Gemilang's argument that the provision works only to compel an able principal as Section 30 of the CIPAA does not provide for such a distinction. In this regard, the Court of Appeal also remarked that a Section 30 direct payment would not amount to preferential treatment.

Accordingly, CT Indah's appeal was allowed. The Court of Appeal gave judgment against BHL Gemilang. The judgment was reported in *CT Indah Construction Sdn Bhd v BHL Gemilang Sdn Bhd* ([2020] 1 CLJ 75 (Court of Appeal), Abdul Rahman Sebli JCA). CT Indah applied for leave to appeal to the Federal Court.

Federal Court decision

At the Federal Court, BHL Gemilang argued, among other things, that there was no decision on the conflict between the CIPAA (ie, the direct payment provision) and the Companies Act 2016 (ie, the priority of payments provision). BHL Gemilang argued that Section 30 of the CIPAA contravenes the *pari passu* principle, which is a fundamental principle in winding-up or company law. In this regard, references were made to authorities such as:

- *Sime Diamond Leasing (M) Sdn Bhd v JB Precision Moulding Industries Sdn Bhd (in liquidation)* ((Federal Court), Edgar Joseph Jr FCJ);(4) and
- *Malaysian Trustees v Transmile Group Bhd* ((Court of Appeal), Ramly Ali JCA).(5)

By citing Section 31(2) of the CIPAA, BHL Gemilang argued that the CIPAA does not intend to override insolvency rules. As illustration, reference was made to:

- *Lim Poh Yeoh v TS Ong Construction Pte Ltd* ((High Court), Edmund Leow JC)(6) for the proposition that the Building and Construction Industry Security of Payment Act (Singapore) does not override insolvency or bankruptcy rules; and
- *Dubon Bhd (in liquidation) v Wisma Cosway Management Corporation* ((Federal Court), Nallini Pathmanathan FCJ)(7) for the proposition that Section 77 of the Strata Management Act 2013 does not override the priority of payment regime.

However, CT Indah argued that on the facts of this matter, there was no conflict between the liquidation rules and Section 30 of the CIPAA. *Glow Heating* was a case in point and favoured CT Indah. In light of this, there was no disagreement between the principles in *Glow Heating* and those in *B Mullan*. In *Glow Heating*, the direct payment was 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* refused direct payment.

Likewise, in *Hitachi Plant Engineering & Construction Co Ltd v Eltraco International Pte Ltd*,(8) the Singapore Court of Appeal observed that the *Glow Heating* approach was applicable only to a situation where a direct payment obligation exists and not when payment is merely voluntary or discretionary. In *Hitachi*, the direct payment was contingent upon the exercise of a discretion by the project architects. Accordingly, the *Glow Heating* approach was not applied.

Thus, on the facts of the present matter, there was indeed a mandatory obligation – a statutory one. Once Section 30 of the CIPAA was triggered, BHL Gemilang had to make direct payment. Therefore, it was argued that such a statutory obligation must be viewed as being of equal strength to the mandatory contractual obligation in *Glow Heating*. BHLB's assets must be taken by its liquidator subject to the contingent liability of this direct payment.

Thus, case law across various jurisdictions is consistent with the Court of Appeal's decision. As such, the Federal Court dismissed BHL Gemilang's application for leave to appeal the Court of Appeal's decision. Thus, the Court of Appeal's decision remains good law.

Comment

Section 30 of the CIPAA serves as a crucial remedy to ensure liquidity during the continuance of a construction project for subcontractors in the construction industry. The outcome of the series of legal battle on this aspect safeguards subcontractors' interests and preserves the spirit of the CIPAA.

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Endnotes

- (1) *BHL Gemilang Sdn Bhd v CT Indah Construction Sdn Bhd*, Federal Court Civil Application 08(f)-218-05/2019(W).
 - (2) *B Mullan & Sons (Contractors) Ltd v Ross* ((1996) 54 ConLR 163).
 - (3) *Glow Heating Limited v The Eastern Health Board* ([1988] IR 110).
 - (4) *Sime Diamond Leasing (M) Sdn Bhd v JB Precision Moulding Industries Sdn Bhd (in liquidation)* [1998] 4 MLJ 569.
 - (5) *Malaysian Trustees v Transmile Group Bhd* [2012] 3 MLJ 679.
 - (6) *Lim Poh Yeoh v TS Ong Construction Pte Ltd* [2016] 5 SLR 272.
 - (7) *Dubon Bhd (in liquidation) v Wisma Cosway Management Corporation* ([2020] 1 LNS 503).
 - (8) *Hitachi Plant Engineering & Construction Co Ltd v Eltraco International Pte Ltd* [2003] 4 SGCA 38.
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