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Where is the line drawn for conditional payment under CIPAA 2012?

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Introduction

The "pay when (if) paid" clause in construction contracts, is now void pursuant to section 35(1) of Construction Industry Payment and Adjudication Act 2012 (CIPAA). Section 35 (1) of CIPAA reads as follows:

35 Prohibition of conditional payment

- (1) Any conditional payment provision in a construction contract in relation to payment under the construction contract is void.*
- (2) For the purposes of this section, it is a conditional payment provision when-*
 - (a) the obligation of one party to make payment is conditional upon that party having received payment from a third party; or*
 - (b) the obligation of one party to make payment is conditional upon the availability of funds or drawdown of financing facilities of that party.*

Simply put, contract clauses that make payments to one party (usually the subcontractor) that are contingent upon payment being received by the other contracting party (usually the main contractor) are void under CIPAA. This is because CIPAA is meant to provide a speedy resolution to payment disputes, and "pay when (if) paid" clauses delay payment.

While section 35(1) of CIPAA offered much-needed relief to contractors in the industry, the Court of Appeal decision in *Lion Pacific Sdn Bhd v Pestech Technology Sdn Bhd*⁽¹⁾ may have shaken the industry's perception on conditional payment contract clauses in relation to section 35(1) of CIPAA.

The issue before the Court of Appeal in *Lion Pacific* was whether the adjudicator and the High Court judge had erred in interpreting a "pay when certified" provision as a conditional payment clause, thus rendering the clause void pursuant to section 35(1) of CIPAA.

Facts

The government had accepted a tender submitted by Konsortium Skypark Link Sdn Bhd-Lion Pacific Sdn Bhd (consortium) for a construction project. This was the main contract.

The consortium appointed Lion Pacific Sdn Bhd (LP) as sub-contractor for the system works package parcel of the project (the works). LP then appointed Pestech Technology Sdn Bhd (PT) as LP's sub-contractor for the works by way of a sub-contract.

PT claimed that a sum of 24,902,980.45 Malaysian ringgits was owed by LP to PT for the works. PT's claim was referred to adjudication.

LP disputed PT's claim by relying on clause 4.1 of the sub-contract, (ie, payment for the works will only be due from LP to PT upon certification of work by the Ministry of Transport (MOT)). The MOT had not certified PT's work at the time of the adjudication.

Clause 4.1 of the sub-contract states as follows:

*The Sub-Contract payable to [PT] by [LP] to be paid by [LP] to [PT] as payment milestones. **This will be exactly back to back with the terms of the Main Contract.***

However the following schedules shall be tentatively followed.

Submission of Claim with all documents 07th of every month.

Verification and approval by ICC [Independent Checking Consultant]-MOT 15th-24th every month.

Payment to [PT] 40 days after certification by MOT. (Emphasis added.)

High Court

The adjudicator found that clause 4.1 of the sub-contract was in fact a "pay when paid" provision, which was prohibited by section 35(1) of CIPAA. LP's defence, which relied on clause 4.1, was dismissed by the adjudicator. Parts of PT's claims were allowed in the adjudication decision.

Later in the court proceedings for setting aside and enforcement of the adjudication decision, the judge concurred with the adjudicator's interpretation of clause 4.1 of the sub-contract regarding section 35(1) of CIPAA. LP's application to set aside the adjudication decision was dismissed.

Court of Appeal

LP then appealed to the Court of Appeal. The Court subsequently overturned the High Court's decision and allowed LP's appeals.

The Court of Appeal's decision was as follows:

- Clause 4.1 of the sub-contract was a "pay when certified" not a "pay when paid" provision. The Court found that the adjudicator had mistaken the clause for a "pay when paid" provision, when the clause was actually an agreed contract term between the parties regarding whether PT had completed its works and was entitled to be paid. The parties had mutually agreed that LP's obligation to make payment would only arise upon certification of the works done by the MOT – failing which, the works could not be considered complete.
- The adjudicator mistaking the "pay when certified" provision for a "pay when paid" – prohibited by section 35 of CIPAA – amounted to incorporation of a new contractual term into the sub-contract that the parties did not agree to. The Court found that the adjudicator had no jurisdiction to do so.
- As far as section 35(1) of CIPAA was concerned, a "pay when certified" provision (ie, clause 4.1 of the sub-contract) could not be construed as a conditional payment clause. The Court went on to hold that the High Court judge had erred in holding that clause 4.1 of the sub-contract was invalidated by section 35(1) of CIPAA as his interpretation went beyond the express intention of the contracting parties.

Considering the above, the Court of Appeal found that the adjudicator had acted in excess of his jurisdiction and had failed to carefully consider and appreciate LP's main substantive defence, which hinged on clause 4.1 of the sub-contract. The Court allowed LP's appeals with costs and the adjudication decision was set aside.

Comment

The "pay when (if) certified" clause is common in construction contracts. Verification of work done in the form of a certificate is a reasonable pre-requisite for entitlement to payment. The Court of Appeal's decision in *Lion Pacific* makes it clear that a "pay when certified" clause is not a conditional payment clause and thus falls outside the scope of section 35 (1) of CIPAA. However, it is worth noting the following:

- Impugned clause 4.1 suggests that the payment to PT is back-to-back with the main contract.
- Had the certification of MOT (acting for the employer in the main contract) been a genuine requirement for verification of PT's work done and not intended to incorporate a "pay-when-paid" arrangement? Why had the impugned clause 4.1 referred to the terms – presumably payment terms – of the main contract?
- The reality of the construction industry is that work done is often not certified on time, thus the contractors are not paid. With the Court upholding the "pay-when-certified" clause unconditionally, contractors are now confronted with more challenges when seeking payment for work done.
- The decision in *Lion Pacific* dealt with contractor's entitlement to payment for uncertified work in the context of section 35 (1) of CIPAA. An adjudicator is empowered by section 25 (m) of CIPAA to review and revise any certificates issued or to be issued. This means that even if the contractual agreement between the parties provides for the issuance of a certificate prior to payment, the absence of certification cannot deprive the unpaid party from availing the adjudication process.

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Endnotes

(1) *Lion Pacific Sdn Bhd v Pestech Technology Sdn Bhd* [2022] MLJU 2109.