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LAW FOR CONSTRUCTION CONTRACTS ADMINISTRATORS

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HALF DAY SEMINAR ON LAW FOR CONSTRUCTION CONTRACTS ADMINISTRATORS

1. WHAT IS LAW?

1.1 An attempt to define the law

Law is:

- A system of rules
- Backed by sanctions

It can therefore be seen that every civilised country has theoretically a legal system but the important question is the practical one of how well can the laws be enforced. Put it another way, how closely does the actual outcome of a trial correspond with that which is predicted by an experienced lawyer looking at the facts objectively, especially in a clear cut case, or as lawyers like to put it in an "open and shut case".

It is therefore important for the sake of business expediency that the public has unquestioning confidence in the judiciary. Whilst perhaps 99% of business transactions are concluded (in construction contracts the settlement of the contract is said to have happened upon the finalisation of and agreement by the parties to the contract accounts) without the need to go through the process of dispute resolution, a large proportion of them reach conclusion in this manner because the parties know that if they go too way out of line, the aggrieved party would probably succeed in an action of the case. This often keeps the parties in check and ensure their adherence to their bargains.

1.2 Sources of law

Just as one would quote say Tomlinson when making an assertion in a report for an investigation into observed excessive settlement of rockfill that even in an ideal situation consolidation of 0.5% of the total height of the fill can be expected, lawyers have to quote the bases of the submissions they make to support the legal positions they take in litigation and judges also have to do so in their judgments. These bases are what is termed as the "sources" of law.

The law exists within a rigidly structured framework with the sources being as listed below in descending order of importance:

a) The Federal Constitution (bear in mind the fact that the individual states have their respective constitutions but these seldom affect daily business transactions)
b) Legislation by Parliament, but the Malaysian Parliament may by a 2/3rd majority choose to amend the Federal Constitution. So in Malaysia where the ruling party commands an overwhelming majority in Parliament, there is for practical purposes little difference between a piece of legislation and the Federal Constitution because any conflicts between the former and the latter can be easily resolved by amending the latter
c) Secondary legislation (such as bylaws enacted by various ministries, examples those of the Ministry of Housing and Local Government, Local Authorities such as DBKL, MPPJ, MPAJ which would affect the construction industry)
d) Decisions by the courts – Federal Court, Court of Appeal, High Court in descending order of hierarchy
e) Decisions by the courts of other Commonwealth countries - but these are of persuasive authority only, except English cases decided before 1956
f) Law textbooks – ditto-

So if a provision of any source of law standing lower down in hierarchy is in conflict with a higher source, an action may be brought to strike down the offending provision of the lower source.

If a judge or a magistrate were to make a decision which is against the provisions contained in any one of the higher sources of law the judge's or magistrate's decision is invalid and the party who has suffered from it can appeal against it successfully. Thus for example if a judge of the High Court is to make a decision which is conflict with that of an earlier judgment of the Court of Appeal, the decision can be successfully appealed against.

It is pertinent to note that contract law in Malaysia is essentially regulated by the Contracts Act 1950.

1.3 Criminal law, tort, contracts

For our current purpose we will look at three law subjects, i.e. criminal law, tort, and contracts.

Criminal law

This is the most severe branch of the law in which a litigant has no choice, i.e. if a person commits a crime not knowing that he has committed a crime, he is guilty nevertheless. Ignorance of the law is never a defence. By his mere presence in a country, a person submits himself to the jurisdiction of its courts. Do you recall what you read on the embarkation cards you had to fill when you last visited Singapore? What were the only words in red about? So if you (even if you hold an American passport) commit a crime in Singapore and the act is not an offence in your home country, no matter how your country protests, you will still suffer the punishment meted out by a competent court in Singapore. You remember the Michael Fay case? Did the protests of the American Government have any real effect?

Tort

This is the branch of law which makes a doctor liable to his patient if he administers penicillin without first inquiring if the latter is allergic to it, renders a negligent driver liable for damages to a pedestrian whom he knocks down, and (of interest to us) allows a careless supervising engineer to be responsible to the families of persons killed when a building collapses. This is also the branch of the law which makes a person who makes a statement which tarnishes the reputation of another person liable to that person. The most important area of the law of tort is that of the tort of negligence.

To sue in tort, it is not necessary for there to be a contract between the parties, although the existence of a contract does not prevent an action in tort.

In order to sue in nuisance, it is necessary to prove that a duty of care is owed. Thus for example, a taxi driver owes a duty of care to his passenger in the same way that a doctor owes the same duty to his patient. A house owner who allows noxious fumes to escape into his neighbour's house is liable under the tort of nuisance. You can see that in the first two instances that a contract exists between the parties whereas in the 3rd instance there is no contractual relationship.

Returning to the case of the supervising engineer, he will be responsible to the occupants of an apartment block despite there being no contractual relationship. This happens when the apartment owners buy their units from a developer.

Contract

A contractual relationship can exist between two parties only if they consent to enter into it. However, it is not necessary for the parties to be conscious about the fact that they have entered into a contract. Thus for example, if you walk into a restaurant and order five dishes for your family of five and you do not ask the price and you are later charged RM 200, you have to pay the price as eventhough it may be high, it is not that unreasonable and you have to pay the bill.

In this case and in contrast to a tortious relationship, by entering into a restaurant and ordering dishes which order has been accepted, you have entered into a contractual relationship with the restaurant owner.

Comparison of contract and tort

It is important to note however that it is not possible to sue under tort for what lawyers call "pure economic loss". Thus for example, if a child's parents buy an expensive toy from a shop, and the toy is faulty and explodes, injuring the child and damaging furniture. The injury to the child is personal injury, the damage to the furniture is property damage, but the damaged toy is pure economic loss. The child (the father will sue as the child's parent) can sue the vendor under contract for the costs incurred in all three situations as being the likely consequence of the defect in the toy.

However, what if the vendor has gone bankrupt and will not be able to satisfy judgment, the child will be looking to suing the manufacturer. He would be allowed to do so only with regard to the injury and the furniture but not with regard to recovering the cost of the damaged toy. This is because the relationship between the child and the manufacturer lies in tort and not contract as whilst it is apparent that a defect of the said nature would cause not only physical damage to other property but also injure persons but there is no contract between them. If the courts were to allow the child to recover the cost of the toy, it will make the fact of the existence of the contract between the child and the vendor meaningless.

1.4 Law of contract

In order for there to be a contract, four essential elements must be in place:

- Offer by the offeror
- Acceptance by the offeree
- Consideration – this is the amount payable

- Certainty of terms – in order for a contract to exist between parties, we need to know exactly what they have agreed.

Thus for example when an employer sends out a Letter of Acceptance (it is actually a misnomer, it would be more accurately described as a letter of offer) it is making an offer which is then accepted by the contractor. The contract sum stated therein is the consideration and the Specification, Drawings, and Bills of Quantities provide for certainty of terms.

The law treats two parties who enter into a contractual relationship as equals and when administering a contract this fact always has to be borne in mind. The fact that contractors are reluctant to offend their client often lead to contracts administrators to blurring the distinction between contractual rights and power enjoyed by virtue of one's position as a contracts administrator especially when one is an engineer in the employment of the Government or even private sector clients. Whilst arbitrary administration quite often finds little resistance with contractors, it is always good to remember that the better approach by clients'/main contractors' contracts administrators is quite often to earn moral authority through professional scrupulous administration of contracts. A proactive approach is often better as it helps to bring to fruition the common objective of the parties to materialise a project which will bring a benefit to its goal of early completion and to specifications.

The point that is made above is that clauses in contracts have to be construed objectively. It is within the right of the contractor's contracts administrators to challenge an employer's S.O. or representative but in the interest of both the contractor's bottom line as well as the progress of the works, this approach has to be taken in parallel with a human perspective. In other words, we need to remember that the persons on the other side is human like us with spouses and kids without at the same time forgetting the fact that we are on different sides of the contractual divide with our respective employers to answer to.

What is arbitration?

Arbitration is a means of dispute resolution to which the parties to a contract must agree in the contract entered into. If the contract between the parties does not include an agreement to refer any disputes to arbitration, then disagreements will have to be agreed to by the courts. However, there is nothing to prevent in such a situation the parties reaching agreement to refer the dispute to arbitration when a dispute actually arises. The following are the peculiar features of arbitrations:

- The parties usually get to agree on identity of the arbitrator, but often when the parties cannot agree, either the contract will state that the arbitrator is to be appointed by a person such as for example the director of the Regional Centre for Arbitration, the President of the IEM, or even the President of the Federation of Malaysian Manufacturers. If the contract is silent, then upon the application by one of the parties, the arbitrator will be appointed by a competent court.
- As such the arbitrator is usually someone who is conversant with the subject matter of the dispute. There was actually a case of a judge who successfully advised the parties in a suit to refer their dispute on the supply of piles to refer their dispute to arbitration because he felt that an arbitrator is better able to understand the issues involved
- An arbitration is a private hearing. As such there is no "washing of dirty linen in public"
- You have to pay for the arbitrator to listen to the dispute. The fee ranges from RM 2,000 to RM 4,000 per day depending on the standing of the arbitrator. The different professional bodies have their respective scales of fees. The services of the judge comes for free
- The rules of evidence in an arbitration are less formal, and the parties may agree on their own rules. This follows from the fact that the Evidence Act 1952 is not applicable to arbitrations. However, the general principles of

evidence law remain applicable and fundamental rules such as the requirement that the party who alleges must prove will remain applicable.

Apart from the above, the procedure at arbitrations are almost identical to those in an action heard by the courts. For example the steps in litigation, i.e. submission of statement of claim, defence and counter claim, reply and defence to counter claim, summons for directions, close of pleadings, discovery, and requests for further and better particulars are exactly followed in arbitration. Once an award has been made by an arbitrator, it may be registered with the High Court following which it has the same status as an award by the High Court itself. Bear in mind the fact that the dispute can be as simple as whether a certain fabric supplied is compliant with that which a merchant has contracted to supply.

Once an arbitrator has been appointed, he cannot be removed save with an order of the High Court. Such an order will be given only in the most limited of circumstances.

How about adjudication?

Adjudication is a process of the temporary resolution of disputes during the course of the construction. It involves an adjudicator who is normally appointed for the course of the project making binding but interim awards upon referral of disputes. The awards are interim in the sense that the same issue(s) may again be referred to arbitration after the issuance of the Certificate of Practical Completion / Taking Over Certificate. In the UK for example, it is now mandated by law that all construction contracts disputes are first referred to adjudication before it may be litigated upon at the close of the contract. The benefit of the UK system is that the adjudicator is required to complete whatever hearings and come out with an award within a short time frame of 28 days of the dispute being referred to him and hence help prevent disputes from becoming big and unwieldy. The rules of evidence in adjudication are less strict and the adjudicator is sometimes allowed

under the rules of adjudication to speak to the parties individually, i.e. in the absence of the other party.

And what is mediation?

Mediation is a non-binding means of dispute resolution in which the mediator's role is to try to make the parties see their dispute from a different angle, i.e. see the issues from a fresh perspective. This is useful because the dispute probably arose because each party is adamant that his approach is correct in the first place.

In the CIDB Form of Contract, it is mandatory that any issue which a party wishes to be arbitrated upon must first have been referred to have been mediated upon failing which he will have to accept the other party's position.

1.5 Substantive law v Adjectival law

The law governing the rights of a party to any suit is described as substantive law. For example, for a person to be convicted of a theft, he must be proved to have:

- Taken property belonging to another knowing it to belong to another
- The property must have been taken dishonestly
- With the intention to permanently deprive the other of the property

In other words there must be the dishonest taking of property known to belong to another with the intention of keeping it for oneself. If the prosecution fails to prove any one of the elements, the judge will acquit the accused without even calling for his defence.

However, the question of whether the magistrate can order the remand of a suspect and how long the remand order will be for, the question of whether a statement made to an accused's spouse can be used in evidence are issues of adjectival or procedural law. The fact that an accused person has been remanded

in custody but eventually found not guilty after a trial does not make him any less guilty in the eyes of the law. Therefore if a person has been tried but acquitted of an offence of assault the judge in a subsequent trial of the same person after conviction for an offence of robbery cannot give the person a heavier sentence because the earlier acquittal cannot be taken into account, even if the person had been held for a long period pending acquittal.

Therefore in the law of contract, the question of whether an exclusion clause is operative to exclude an employer's liability for loss and expense is an issue of substantive law because it affects the parties' rights directly, but the issue of how an action is to be commenced, of whether a particular letter can be used in evidence, of whether arbitration should be the means of solving the dispute are issues of procedural law.

2. LAW OF EVIDENCE

The law of evidence (for our purpose) sets out the party who is required to prove any fact or contractual entitlement. It also sets out the standard of proof which has to be satisfied.

Thus for example, if liquidated and ascertained damages (LAD) are recovered from a contractor who is delayed in completion, and the contractor challenges this in an arbitration, the employer will be required to adduce evidence to prove that the contractor has in fact delayed. As such, the employer may adduce letters (unrefuted or weakly responded to) to the contractor complaining of delay in, or a lack of progress in executing the works a few days before the completion date, and say minutes of a meeting held a few days after the due completion date urging the contractor to expedite the works. Once he has produced the evidence and the arbitrator seems to have accepted it, the contractor would probably want to adduce his own evidence to try to convince the arbitrator otherwise. If he fails to do so the contractor will probably fail to resist the deduction for LAD.

The standard of proof in civil cases is on a balance of probabilities, i.e. you have to convince the judge or the arbitrator that your version of the facts are more likely to be true than that of the other party's and you will win the case. This is in contrast to the standard of proof in criminal cases where the prosecution is required to prove their version of events to beyond reasonable doubt. Thus for example, in the example of the recovery of LAD, if the employer succeeds in convincing on a balance of probabilities that the contractor did in fact delay the completion, then he will be entitled to recover LAD. However, arbitrators are human and will probably want strong evidence that there has been delay and it is not necessary for them to state how convinced they are in their awards before allowing recovery of LAD.

A good example of how critical the burden of proof is in civil disputes can be gathered from one case:

> *A main contractor held back payment for a pavement sub-contract alleging that the dense bitumen macadam was of insufficient thickness. On being challenged to prove their allegation, they had to backdown probably because he could not prove it. It is an accepted rule of law that he who alleges must prove.*

In practice, this translates into the critical need for the keeping of accurate records as these act as evidence in the event of any dispute. Thus for example, in order to minimise a claim for costs arising out of an extension of time application, it would be prudent to keep daily records of resources so that any claims may be substantiated in the negotiation process.

3. SPECIAL FEATURES OF CONSTRUCTION CONTRACTS

Construction contracts are from a legal point of view also contracts like all other contracts such as contracts of insurance, placing an order for a car, or paying a deposit for a house. However, due to the frequency of each category of transactions, a body of case law has developed in regard to each. However, unlike purchase of cars and developer-buyer transactions, construction contracts are between two business entities which can be said to have more or less equal bargaining power. As such, in Malaysia the legislature has not stepped in to regulate relationships between parties to contracts.

Due to the special characteristics of construction contracts such as unforeseen soil conditions, the sometimes big area of land involved (such as in highways, and dam jobs which give rise to potential errors in surveys), the need for refinement of the client's requirements as the construction progresses (giving rise to the need to execute VO works), susceptibility to weather conditions, complexity of constructional activities, and extensive logistical requirements, certain terms to cater for these characteristics are almost universal in construction contract standard terms. Another important point to note in regard to construction contracts is that the administration of these are often carried out by another party, i.e. consultants who are then the agents of the employer. These standard clauses and peculiar points to note are as follows:

3.1 Allowance for extensions of time

This is necessary to protect the risks of employers as in the absence of the allowance, employers lose the right to recover liquidated damages.

The right to impose LAD is necessary not only to motivate the contractor to complete in time but also to ensure that the employer is not left without a remedy as delay inevitably causes economic loss. Imagine for example the loss which the

owner of a RM 100 million hotel with 100 rooms hired out at RM 250 per night will lose in the event of delayed completion.

In the event that delay is caused by an event which is not covered by the extension of time clause, time would become at large and the contractor is entitled to complete the works within a reasonable time frame. In such a situation the employer cannot recover LAD.

This follows from the fact that the parties to a contract are bound by the completion date agreed to at the time of entering into the contract, and if the contractor is delayed due to no fault of his, then the contractor is discharged from compliance with the completion date. As such, all standard forms of construction contracts will contain the events which entitle the contractor to an extension of time. It is interesting to note the inclusion of the following factors in 23.7 which entitle the contractor to an extension of time in PAM Form:

- By reason of a force majeure – this would include occurrences such as a war, sinking of a ship bringing specialist equipment – (i)
- Exceptionally inclement weather. This does not mean that just because 300mm of rain falls in December, 2000, there would automatically be extension of time for the days on which rain fell. Like in all contracts administration works, one must look at the total rainfall for a particular month, compare it against the average rainfall for that month over say, the last 20 years, and if the rainfall is say 150mm more than the average, then we should look at daily rainfall records to determine the days when it may have been impossible to work. The type of activity is also important. For example, work on a rockfill dam can continue even after 50mm of rainfall whereas even 20mm of rainfall will put a stop to earthfill works. – (ii)
- Occurrence of risk covered by insurance. Thus occurrence of storm, fire, explosion, damage caused by aircraft, and flood would entitle the contractor to an extension. It is interesting to note that in another forms of contract the

entitlement is subject to the occurrence not having been brought about by the contractor's negligence. – (iii)

- Civil commotion, strikes, or lockouts which may affect the progress of the works – (iv)
- An instruction issued by the S.O. under Clause 1.2 (discrepancy within Contract Documents), 11.2 (variations), 21.1 (delay in site possession), 21.4 (postponement of any work). The right to an extension of time under this is subjected to the implied condition that the instruction had not been given to redress a default of the contractor. – (v)
- Delay in issuance of Drawings, information, instructions, details, or Drawings by the Architect. This is to cover a situation in which the Architect holds back for example setting out information perhaps while pondering a design consideration. –(vi)
- It is interesting to note that the contractor is made responsible for a default of his nominated sub-contractor as only delays due to no shortcoming of the nominated sub-contractor would entitle the contractor to an extension of time. In this paragraph the Contractor would be entitled to an extension of time for delays by his NSC if the delays by his NSC were caused by the same factors as those which would enable the Contractor to an extension - (vii)
- An act of prevention or breach of contract by the Employer not specifically mentioned in Clause 23.7. This clause is interestingly put here to prevent time becoming at large if the Employer causes a delay of a nature not contemplated – (xi)

An extension of time is not in itself an entitlement to costs as costs will only be allowed when specifically stipulated. The causes entitling the contractor to an extension of time which also lead to entitlement to costs is in turn provided for in Clause 24.2. Thus the contractor is effectively entitled to costs only in circumstances in which there has been no default by the Employer which thus excludes force majeure, exceptionally inclement weather, mishaps covered by insurance, civil commotion and strikes.

Like all claims for costs incurred, the contractor should be required to submit records of resources expended such as records of site staff and site establishment (site office, site transport).

3.2 Insurances

Insurance is a necessary part of all commercial transactions in which the client makes a payment, either partially or in full before taking delivery of the goods or the end product.

Some basic points on insurance practice / insurance law:

- A contract of insurance is a contract of "*utmost good faith*". In other words, all material facts must be disclosed, regardless of whether the information is asked for or not. If a fact is omitted in answer to a question, eventhough the omitted fact in no way led to a damage and hence a claim, the insurer will be likely to succeed in avoiding the claim. For example in a case involving a claim for payment out of a life insurance policy with the claim having no bearing with the fact that the woman had previously had a Caesarean section, the insurer managed to avoid the claim on the basis that in answer to a question on whether she had previously undergone an operation, she had declared "No.". [*See Kumar v Life Insurance Corpn of India,* [1974] Lloyd's Rep. 147]. Thus, when a contractor is securing insurance for a project, it is advisable to ensure that the insurer and his broker is given the opportunity to inspect the contract documents when an application for insurance is made and to have this fact recorded, i.e. by means of a letter confirming the fact that a set of relevant drawings, BQ, contract scope of works, etc has been made available. Whether the insurer actually bothers to inspect the documents is another matter.

- There is no advantage to be gained by insuring an interest twice (life, personal accident insurance is different) as contracts of insurance are contracts of indemnity and you cannot indemnify against a risk twice. The total sum claimable in such a situation would be the amount of the loss.
- The insurer has a right of subrogation, i.e. he has the right to step into the shoes of the insured after he has indemnified the insured and can pursue an action against the party who caused any loss. For example, if a contractor's hired crane collapses on a building and causes heavy damage, the insurer may after paying the employer for the loss, take an action against the hirer using the name of the employer. The damages recovered by the insurer will go to the insurer. Thus when there is a 3rd party claim, it is always best to let the loss adjuster negotiate the compensation payable.
- Take note of such limits on claims such as the maximum claimable per incident, excess clause, and number of incidents for which claims may be made. It is possible to have the limits reduced for additional premium.

3.2.1 Damage to the Works, damage to 3rd Parties

Insurance is a necessary part of all commercial transactions in which the client makes a payment, either partially or in full before taking delivery of the goods or the end product.

The practice in the construction industry now is to accept construction all risks (CAR) policies which cover both damage to the works as well as 3rd Party liability. CAR policies cover all damage suffered in the course of construction except for risks which are excluded. Risks normally excluded are:

- Any failure in any portion of the Works due to a defect in the Works itself. Therefore, if a column fails and collapses due to defective workmanship, the

damage to column itself is not covered, but collapse experienced by other parts of the building as a result of loss of support is covered

- Economic loss. Thus for example if a generator forming part of a building still in the process of construction is damaged say by fire, the cost of repair or replacement is claimable, but the cost of hiring another generator in the meantime is not. Accordingly, liquidated damages is not claimable, i.e. the contractor cannot claim for LAD suffered, and the employer cannot claim for the LAD which he is deprived from recovering. Note that specialised policies are available to cover such situations. An example would be advanced loss of profit insurance which covers an owner against the loss of revenue he is likely to suffer if there is a delay in completion.
- Willful acts or .willful negligence. An example of the latter is proceeding with excavation works being well aware of the existence of underground services without piloting being carried out.

In the event of the occurrence of an excepted risk, the insured will have to bear the amount of the claim himself.

3rd Party liability is the damage suffered by an upstream landowner when a drain is choked by construction debris and the drain overflows. 3rd party damage is potentially enormous like when a spanner drops from a bridge constructed over a highway and it hits a 30 year old brain surgeon, killing him. Another example will be a crane collapsing on a neighbouring building.

3.2.2 Injury to workmen, staff

Workmen

All employers are required by s26 of Workmen's Compensation Act 1952 to take up Workmen's Compensation Insurance for his workmen. Failure to comply with this will render an employer liable to fine or imprisonment or both.

All employers with workmen earning less than RM 2,000 p.m. are required under the Employees' Social Security Act 1969 to make contributions on behalf of their workers.

There is now also legislation requiring separate policies for foreign workers.

In the event of injury involving negligence by an employer, whatever compensation ordered to be paid by a court or industrial tribunal will be paid less the compensation paid under Workmen's Compensation, SOCSO or Foreign Workers' Insurance.

Other employees (clerical, supervisory)
The above insurances do not cover this category of construction personnel. As such it is advisable for employers to take separate insurance such as personal accidents policy to cover them. Please note however that the provisions of the Civil Law Act 1956 exclude any sums payable under insurance policies from any sums which may be recovered in an action under negligence. As such it is advisable for employers to seek legal advice on this matter.

3.3 Contract Security

This is a very important aspect of construction contracts, i.e. the employer's need to secure himself in the event the contractor fails or absconds. Such failure / absconding falls under two broad categories:

Employer needs to engage another contractor to takeover the works – when contractor absconds or runs into financial difficulties
This involves the contractor not only in having to incur higher cost in awarding another contract at a higher contract sum, but also in additional consultancy fees, delayed completion with its attendant loss of revenue (this would have been quantified as the LAD), and liability to 3rd parties such as happens in the case of the employer being a developer.

Major failure of the works

If construction works faces major failure, the costs incurred may include the following:

Remedial works – the pure engineering cost is more expensive than doing it right in the first place. You will need to excavate, support, conceal from public viewing, etc., etc.

Loss of use – this economic cost can be very high such as when parts of a building has to be shut down.

Damage to 3rd parties – Highland Towers being an example which springs to everyone's minds.

A situation like the Gua Tempurung failure is a good example. The remedial works were very expensive as the earthworks had to be carried out at a location which was half cut / half fill width wise and substantial costs were incurred in the detour. The stretch of the highway had to be closed for about 2 weeks thus incurring substantial loss of revenue. Fortunately, the loss of life was minimal otherwise the 3rd party liability would have been horrendous.

The implication of the above is that the potential liability in the event of default by the contractor is very high, especially in the event of a major defect in the construction. In such a situation the loss can amount to a sizeable proportion of the contract sum in which event the 5% retention plus 5% performance bond (let alone 5% retention only) would not be sufficient to cover the loss, hence the importance of a bond. On the other hand, such major defects are relatively rare, hence the industry has adopted through practice 5% performance bond in the case of civil and structural works, and 10% in the case of M&E works.

It is not a matter of legal necessity that bonds must be issued by banks and suitably worded corporate / personal guarantees are equally enforceable as they

are both governed by the same legal principles. But bear in mind the fact that judgment and satisfaction of judgment are not equal. The author has often in the past accepted corporate guarantees, often from parent companies who are 1st board public listed companies. The benefit to be gained from this is that the premium which would otherwise be payable may be saved and this often translates into a reduction in the contract price for the client or main contractor.

The important point to note in regard to bonds is their wording. Therefore, it is always safest to adhere closely to the wording contained in the form attached to the contract document. The most important type of bonds are "on demand" or "without contestation" bonds which oblige the bondsman (guarantor) to pay within a certain period of being served a demand by the beneficiary.

A standard on demand clause is as follows:

"*Upon the Contractor failing to fulfill any of the conditions requirements stipulations and obligations contained in the Contract* ***as determined by you in your sole absolute judgment and discretion****, the surety shall forthwith* ***on demand*** *made by you in writing and* ***notwithstanding any objections*** *by the Contractor pay you such amount or amounts as you shall require not exceeding in aggregate the aforementioned amount of RM [……..] by transfer to an account in your name at such bank in Malaysia as you shall stipulate or in such other manner as shall be acceptable by you*" (emphases added)

The effect of the above is that:

- The bondsman (i.e. the bank) cannot resist any calls for him to pay up. Upon paying the beneficiary (the owner), the bondsman's recourse is then to recover from the customer (contractor). Whether the bank is legally entitled to recover will depend on whether the demand had been made in accordance with the bond (the procedure is very simple and there is little possibility of mistake).

- Any protests by the contractor is useless.
- The contractor will then try to recover from the owner via an action. But that will be a long story.

The courts are prepared to uphold any action (via an injunction) to resist a call on an "on demand" bond only in the exceptional situation of fraud by the beneficiary. Fraud in this case means that answering the question "*Have the plaintiffs established that it is seriously arguable that the beneficiary could not honestly have believed in the validity of his demands on the performance bond?*"(per Lord Ackner in *United Trading Corp v Allied Arab Bank 1985*). The court will therefore not look into whether the contractor has a reasonable chance of succeeding in an action to resist the owner's claim for damages.

3.4 Employer's right to instruct variations

It is easy as a contracts administrator to forget the fact that construction contracts are not typical contracts in that an employer's requirements are almost invariably not perfectly defined at the time the contracts are let out, that construction contracts are large scale and involve a lot of technical details often involving complex logistical planning, and that construction contracts have long delivery times resulting in the employer's needs changing over the period. A striking example of this is the one of a bridge in Thailand being 3 spans when the contract was awarded but being revised to 5 span during construction following rising water levels brought about by massive deforestation upstream.

This is in sharp contrast to normal contracts such as contracts for purchase of cars, placing an order at MPH for a book, or contracts of employment. In all these cases it is most unlikely that you will change your mind halfway. For example when I place an order for a car I would probably have made up my mind that I want a 1.6L white automatic Proton Waja and am unlikely to change my mind.

Without a clause allowing the Engineer / S.O. to instruct a variation, the contractor can quite correctly refuse to carry out the instruction and the employer can be held to ransom because the contractor more or less has custody of the site and therefore controls access.

The clauses to allow the execution of VO works are drafted to allow the Engineer / S.O. to instruct them without an agreement on the rates / price.

The main problems a contracts administrator will face in regard to variations are:

Arguments over what constitutes a VO and what doesn't

Examples

1. the drawing indicates that the 300mm thick rubble pitching below the bridge is to be "dry pitching" and the Method of Measurement stipulates that the rate for rubble pitching "includes… … filling in of interstices with cement mortar;". The BQ for the bridge just described the works as "Protection of slope with rubble pitching …". The contractor argued that if the employer wanted the pitching to be infilled with mortar, then it would have attracted a higher rate, to which the employer relented. In this case, it is because of the interpretation of the word "include".

2. a Contractor for a prison project undertaken on a "design & build" basis has undertaken to ensure functionality. The locations of CCTV cameras is indicated in all the various contract drawings with the total number being 73. However, with the installation of these number of cameras substantial areas of blind spots remained such as behind some wide columns. As a result and following rejection of the construction drawings, the contractor had to increase the number of cameras to 125 Nos. Does this constitute a

variation order? Bear in mind the fact that even with the additional cameras there are still blind spots, although substantially reduced.

This is a very common issue (whether an instruction amounts to a variation or otherwise) and each case depends on its own circumstances after looking at the documents as a whole and considering the order of priority of the documents comprising the contract. A very common source of problems is conflicts between different documents comprising the contract. Whilst some standard forms of contract, such as for example, FIDIC list in priority the documents (in Clause 5.2 as follows):

1. The Contract Agreement
2. The Letter of Acceptance
3. The Tender (this includes for example the priced BoQ, the Form of Tender, instructions to tenderers, any forms such as for example particulars of equipment to be supplied as filled in)
4. Part II of the Conditions. These are the conditions of particular application in which some details may be inserted such as for example the ruling language when a contract is drawn up in more than one language, the forms of bonds. However, the one important reason why this precedes Part I, i.e. the Conditions of Contract is that Part II is where any particular conditions and amendments are included
5. Part I. This is the Conditions of Contract.

However it is quite common for a clause to be included which declares the Contract Documents to be mutually explanatory of each other. In such a situation, the clause would normally state "*The several documents comprising this Contract are deemed to be mutually explanatory of each other, but in case of ambiguities or discrepancies, the order of priority will be that accorded by law. If in the S.O's opinion, such ambiguities or discrepancies make it necessary to issue any instruction, ... the S.O. shall have authority to issue such an instruction*" which clause is in fact taken from FIDIC Conditions Part II as an alternative

which an employer may choose instead of that provided in Clause 5.2. In such a situation, if the instruction requires the Contractor to comply with a higher standard than that which can be objectively inferred from the Contract looked at as a whole, he will be entitled to a variation. In such a situation it will be unlikely that the employer will be able to rely on a clause which requires the contractor to identify and raise to the employer's attention any ambiguities in the tender document.

For the above reason, it is always wise for the designer of any project after preparing the Drawings and drafting the BQ, to review the Specification and redraft it if it is not consistent with the Drawings as presumably the Drawings best capture the designer's intentions.

In conclusion on this very important topic to process engineering contractors, the risks undertaken by turnkey contractors tend to be higher as turnkey contracts are by their nature end result oriented and as such leaves more room for interpretation and thus exploitation of ambiguities and dispute. However, the problem is probably less acute in the case of M&E based contractors where mechanical parameters are better defined as against civil or architectural ones. How does one define a conducive environment for example or even "providing an illusion of spaciousness"?

Agreeing on varied rates

This is another problem which often leads to disputes. The basic principle has been captured in Clause 52.1 of the FIDIC Conditions. In other words if any additional works are identical to existing rates then there are no problems, but if there are differences from the existing items, then the differences will have to be reflected in the rates based on the Contract rates as far as possible. The use of dayworks is from the Employer's point of view never a satisfactory solution (and as such rarely agreed to) round this problem as this device is usually a disincentive to the efficient use of resources and is such is suitable only for very

minor works such as a small quantity of additional fill at a site further away from the main site, a very small additional structure, etc. etc.

Amongst the methods used try to make agreement on varied rates simpler are the following:

- To obtain a breakdown of rates into components at pre-award stage. In this regard my personal belief is that honesty is the best policy as with the nature of the construction industry there are a lot of variables and many requirements and parameters are likely to be changed mid-stream;
- Rationalisation of rates before award; and
- Good record keeping during implementation stage which will link the resources and productivity. This is useful in helping to interpolate or extrapolate rates should there be a need to instruct a variation.

3.5 Right to appoint nominated sub-contractors (NSC's)

This power is necessary in view of the fact that the employer often at the time of award of the main contract may not have finalised the details some of the specialist works. In the case of building works these will most often be M&E works (such as air-conditioning, lighting, lifts, escalators, fire fighting, plumbing), and interior decoration works (such as false ceiling, tiling, wall finishing).

The structuring of the contractual relationship is of great importance as whilst most employers wish to avoid the headache of coordinating the main civils contractor with the specialist, the specialist sub-contractor will often take care of his own sphere of work with regard not only to the works as a whole but also that of fellow specialist sub-contractors.

The best way of achieving this is by allowing the main contractor (MC) a fair degree of control over the NSC and in return making the MC responsible for any

defaults of the NSC. In return the MC is allowed a percentage on the NSC contact sum for his profit and attendance.

Some of the features following the immediate above structuring of the MC-NSC contractual relationship are (based on PAM Form of Contract):

- If the NSC delays and causes the MC to delay on the entire contract, the MC is liable for the delay to the whole
- Payments will be made via the MC after the submission by the MC of the NSC's claim to him
- The MC will be entitled to recover LAD from the NSC based on a certificate from the S.O. certifying the delay
- The S.O. is entitled to require proof of payment for a previous progress certification from the MC prior to recommending payment of a subsequent progress claim with the MC progress claim

In view of the heavy burden placed on the MC it is the norm either before calling the tender for nominated sub-contract to get the MC's agreement to the shortlist or before awarding the nominated sub-contract to get the MC's agreement. This practice is in fact given contractual standing in FIDIC Conditions in Clause 59.2 and PAM Form in Clause 27(a).

3.6 Dispute resolution

It is common in the construction industry to include a requirement for adjudication or dispute resolution board to try to sort out the parties' differences before they embark on arbitration. A brief outline of these is as follows:

3.6.1 Adjudication

This is now mandated by law in the UK. The adjudicator has the mandate to make binding decisions pending final decision pending arbitration which may be

commenced only after the issuance of the CPC. The identity of the adjudicator is agreed to at time of signing of contract. The adjudicator is required to visit the site regularly and speak to both parties.

The advantages of this are as follows:

- It prevents injustice especially to the contractual subordinate especially where the contractual superior is trying to take advantage of his stronger position such as for example where he imposes LAD eventhough the delay was caused by him in the first place;
- It forces the parties to take records at an early stage and take stock of their contractual position. In other words, it forces discipline onto the parties; and
- The parties may be able to see their positions more objectively after seeing the findings of a neutral party; and
- Instead of having one resolution of a big dispute (and often after the irrecoverable deterioration of the relationship of the parties)

In fact, the number of disputes in the UK which are referred for resolution by arbitration has now been reduced tremendously following the implementation of this requirement.

The disadvantages of adjudication are that the parties have to go through the mechanics of resolving a dispute twice and hence the additional cost involved

3.6.2 Mediation / dispute resolution board

This is a non-binding means of dispute resolution in which the parties are forced to sit down at a contractually mandated forum and negotiate before they agree that they are unable to resolve their differences and resort to a final and legally binding avenue. The approach here is intended to be non-confrontational as

opposed to our legal system which is based on that of the English common law which is confrontational.

In this, the parties sit down and present their respective viewpoints, with a facilitator involved in the case of mediation. In the case of a dispute resolution board, the meetings are invariably chaired by the senior most official of the contractual superior.

It is only after there is either a breakdown or failure to reach agreement within a preset time frame that one of the parties may seek a legal recourse. In the case of contracts with this provision in Malaysia, the parties may choose to dispense with the requirement and proceed straight to arbitration / litigation.

4.0 RELATIONSHIP BETWEEN THE EMPLOYER AND HIS REPRESENTATIVE

There are two areas of concern here, one being the position of the S.O. as an agent of an employer wherein the main area of concern is his ability to transact on the latter's behalf, and the other is the relationship between the S.O. and the employer.

4.1 The authority of the S.O. to bind an Employer

The S.O. and his representative are in legal terms what we call agent and sub-agent of the employer. In other words, the S.O. acts on behalf of the employer and may be able to bind him in such ways as may have been represented in the contract entered into between the parties or subsequently confirmed.

The S.O. and the S.O's Representative ("SOR") has two basic functions under the contract, viz:

1. To ensure compliance with the contract – in this aspect, the S.O. and the SOR are unable to waive any requirements for compliance under the contract as construction contracts almost invariably make this clear. In FIDIC's CoC, this is stated in Clause 2.1(c). Even if the contract is silent on this point, it will be difficult for a contractor to argue that an obligation under a contract has been waived save when the waiver has been in the most express terms and the contractor has acted to his detriment in reliance on the waiver.
2. To act as the employer's representative on site which often involves committing an employer to additional expense. It would be virtually impossible for a contract to be administered in the absence of the S.O. being empowered to authorize a variation. As discussed above, this authority is delegated to the S.O. in Clause 24 which expressly provides that the "*S.O. may at his absolute discretion issue instructions requiring a variation*". So there is no trouble with this. A delegation of authority allowing the S.O. to instruct a variation to a certain sum is most unsatisfactory as it is often the case that the amount of a V.O. is not known until after it has progressed substantially. Note that this authority has under contract law to be express failing which an S.O. will not usually be able to commit an employer to additional expense.

4.2 The relationship between the S.O. and an employer

The relationship between them comes under both the law of contract as well as under tort. The main issue which normally arises in this area is the S.O's (normally a consultant engineer) liability to his employer in the event of negligence, such as for example happens when as a result of defective design, the employer has to incur additional expense in remedial work.

The test to be employed is whether an engineer has acted with "*a want of competent care and skill to such an extent as to lead to the bad result*" as was held in the English medical case of *Earl v Pierpont* (1862) 3 F.& F.35. In other words, an S.O. is not liable in every event when a mistake by him involves an

employer in additional expense as such a mistake is subject to a test of whether his mistake is serious enough so as to attach liability to him.

The standard of skill against which he will be judged is whether he has exercised the ordinary skill of the ordinary competent man exercising that particular art. However, that does not mean simply that a consultant will be compared to just any ordinary Professional Engineer if he is a specialist in a particular field because his engagement came about in the 1st place because he held himself out as possessing a particular skill.

Also, the specialist will also be earning a higher fee and he will accordingly be judged. Therefore, a consultant with a PhD in soil engineering who has been said to be negligent will be judged by the standard of an average holder of a PhD in soil engineering.

5. CONCLUSION

We should always be mindful of the fact that the law is all about people and does not exist in a vacuum unlike calculus in which mathematicians often toast "may what we discover never be of use to anyone!".

The law exists basically to set out the rights of parties and if they are mindful of not only their rights but those of the other party, disputes can easily be resolved with all the aggravation which they go through before resolution being a mere "misunderstanding". On the other hand, if one of the parties to a dispute is mean and unfair, quite often the realisation that his opponent will be able to enforce his legitimate rights through legal means is sufficient to force a compromise.

Having said that, it has to be remembered that the contractual superior still has the upper hand in any dispute and the other party quite often realistically accepts a sum of upto say RM 1.0 million less because arbitration / litigation is a long and expensive process which may cost upto RM 1.0 million with an outcome which is often uncertain with a lot hinging not only on legal principles but also on the personality of the tribunal and the quality of evidence.

SUPPLEMENTARY NOTES ON POWERS/AUTHORITY OF S.O's/ER'S

1. Introduction

The powers of the Employer's Representative or Superintending Officer (we shall refer only to the ER) are derived from the contract entered into between the parties, i.e. there is no independent relationship between the Contractor and the ER. The ER has a position/standing under the contract directly as a consequence of his appointment by the Employer but the terms of the appointment have no bearing on his authority under the contract.

Therefore, if a certain power under a contract is exercisable only by the Employer, then a contractor should be careful to ensure that any dealings in regard to the matter are conducted with the Employer or that any final decisions/agreements are communicated to/with the Employer. An obvious example is notice of arbitration under the FIDIC conditions.

Note additionally that there are instances in which the ER may act only with the Employer's approval. Again, in such a situation, a contractor would be well advised to always insist on confirmation of approval before acting.

The importance of this issue cannot be over emphasized. Failure to obtain necessary approval of an Employer when authority for any particular act has not been delegated to the S.O. may result in the Employer subsequently denying liability for it. This is especially important in regard to variation of the terms of a contract for example. In such a situation it is best to obtain authorization of the person who signed the contract or at least the person who signed the letter of award.

The dilemma for the person on site is quite often the need to maintain his working relationship with the S.O. and his staff. Strictly speaking if an instruction outside

the powers of the S.O. is given, the contractor is not obliged to act on it. So if he acts on it the contractor is doing something which was not agreed to be within the contemplation of the parties when they entered into the contract. If a project manager really cannot avoid complying without offending the S.O. one way of covering his position is to copy the confirmation letter to the S.O. to the Employer and ensure acknowledgement of its receipt.

Some contracts require that the Contractor shall not comply and the Employer is not bound in the absence of an instruction given in pre-numbered pro-formas. In such a situation, there can be no offence to refuse compliance in view of the very express requirement.

2. Powers of the ER

The starting point to discuss this would be the clause which is standard in all construction contracts, i.e. the "*Engineer shall have no authority to relieve the Contractor of any of his obligations under the Contract*" as is in fact provided in Clause 2.1(c) of FIDIC.

The following are consequences of this provision:

a) If the Contractor is in fact not entitled to extension of time but the ER has granted an extension of time, the Employer is entitled to later for example at arbitration to have such grant reversed.
b) If in order that the Contractor complies with his obligations the Contractor has to expend additional moneys, the ER is not entitled to approve variation orders to assist the Contractor. If such a variation is given, the Employer is entitled to subsequently reverse it.
c) Payments for items of work may at any time subsequently be reversed.
d) In the event of a dispute as to whether an item is a variation and if the ER explicitly agrees to it, the Employer is not barred from overriding the approval

subsequently if on a true interpretation of the Contract, it is included in the Contractor's scope

e) Requirements for approval, especially with regard to temporary works grant the Employer additional protection. If there is failure say of scaffolding, the Contractor will not be able to avoid liability.

f) If defective works were carried out under the ER's supervision, the Employer is not prevented from requiring the Contractor's rectification at his expense.

The conclusion therefore is that one should be very careful in dealing with the ER and to examine any decisions within the context of the Contract.