

Employers' Right in Set-Off as a Vindication for Non-Payment to the Contractors: A Discussion based on CIDB 2000, PAM 2006 and PWD Form 203(A) Standard Form of Contract

Lee Chia Kuang¹, Noor Azlinna Azizan²

Faculty of Technology
Universiti Malaysia Pahang
Gambang, Pahang

chia@ump.edu.my¹, aazlinna@yahoo.com²

Abstract— Non-payment has seriously plagued the construction industry and it severely distressed contractor's cash flow. Despite the fact that industry can only function on the basis of payment by the employers, over the years the employers had relied on the contention to set-off and use it as a basis for their refusal to pay the contractors as the amount due as shown in the payment certificates. In Malaysia, CIDB 2000, PAM 2006 and PWD Form 203(A) Standard Form of Contract are widely used to govern construction projects and manage contractual relationship between contractors and the employers. By reviewing law cases, this paper has been done to explore the magnitude of the employers in using their right in set-off as the basis for non-payment in relation to Common Law, CIDB 2000, PAM 2006 and PWD Form 203(A). The discussion and argument shows that contractors' right in payment can be deprived and challenged due to employer's right to set-off in Common law, CIDB 2000, and notably expressed in PWD Form 203(A) Standard Form of Contract. However, the employers' contention to set-off in PAM 2006 is governed under the "*expressio unius est exclusio alterius*" principle, whereby the set-off principle has been extinguished and only limited to what is dictated and laid out in the PAM 2006 Contract. This paper attempts to shed a light for the contractors, substantiating a platform for the contractors to understand to what extend their payment can be withheld when employers deprive their right for payment based on the allegation of set-off.

Keywords- *CIDB 2000, Expressio Unius Est Exclusio Alterius, Non-Payment, PAM 2006, PWD Form 203 (A), Set-Off.*

I. INTRODUCTION

Construction industry plays a prominent role in a nation's economy and it contributes between 40 and 70 percent of Gross Fixed Capital Formation (GFCF) [2]. However, this industry can only continue to function with the basis that the people and the professionals such as the contractors, consultants and labourers are paid for work and services that have been properly executed [3]. However, our nation has been plagued with non-payment scenario and this has severely distressed contractor's cash flow.

Employers notably like to use set-off as the basis for non-payment. "Set-Off", is a monetary cross claim that is also a defense to the claim made in the action by the claimant, or "deductions of the money to be made" [4]. Over the years, contractors rely on interim certificates as condition precedence for their payment. Such interim certificates usually are issued by the S.O and architects. In some situations, the employers may argue that he is entitled to set-off, and refuse to pay the contractors as the amount due as shown in the payment certificates as a defense for their non-payment. Persistent attempts by employers to rely on the rights of set-off had nevertheless cause undue financial stress on the contractors.

The fact is, the contractor has financial obligations towards its suppliers, sub-contractors and employees. Such financial obligations can only be met from payments via approved interim certificates. Ultimately, the issue of whether there is a right of set-off against interim certificates and withhold payment issued has caused hardships to the contractors.

II. METHODOLOGY

Unlike statistical research, the profound primary data of this legal research are law cases searched by using Lexis Nexis Engine and the relevant clauses from Standard Form of Contracts namely: CIDB 2000, PAM 2006, and PWD Form 203(A). Court decisions are then collated and analyzed, to form and speculate the extent of the employers in using set-off as a vindication for contractors' non-payment in relation to the **three (3)** Standard Form of Contracts mentioned above.

III. COMMON LAW: EMPLOYER'S RIGHT TO SET-OFF

In reality, the employers do have common law right in set-off. The essence of set-off is in defense rather than a cross-action.

TABLE I. RIGHT TO SET-OFF IN COMMON LAW

Cases	Issues/Significance
<i>Mondel vs Steel</i>	Set-off against amount claimed due to damage sustained is allowed, even in the absence of a contrary provision in the contract. Common law right of set-off was derived from this case.
<i>Gilbert-Ash (Northern) Ltd vs Modern Engineering (Bristol) Ltd</i>	No presumption on a general rule which excludes the common law right of set-off in regard to interim certificates.

The common law right of set-off was derived from the case of *Mondel vs Steel*. This principle eventually indicates that when the defendant (buyer of the goods or the employer), is sued by the plaintiff seller or contractor for the price, the defendant, in the absence of a contrary provision in the contract, is allowed to defend himself by setting-off against the amount claimed, any damage which he has sustained as a result of the plaintiff's breach of the contract under which the goods were sold and delivered or the work and labour done and thus showing the diminution of value of the subject matter [1].

Contractors nevertheless should take note that there is no general rule that excludes common law right to set-off in interim certificates. In the case of *Gilbert-Ash (Northern) Ltd vs Modern Engineering (Bristol) Ltd*, the employer had engaged the main contractor using the standard RIBA form (1967 issue) and the main contractor in turn entered into a sub-contract with the sub-contractor. The architect issued interim certificates certifying a certain amount to be paid by the main contractor to the sub-contractor. The main contractor however set-off the amount and paid a reduced amount to the sub-contractor alleging delay and defective work on the part of the sub-contractor. The main contractor set-off the amount based on the set-off clause which states that:

“If the sub-contractor fails to comply with any of the conditions of this subcontract, the contractor reserves the right to suspend or withhold payment of any moneys due to or becoming due to the sub-contractor. The contractor also reserves the right to deduct from any payments certified as due to the sub-contractor and/or otherwise to recover the amount of any bona fide contra accounts and/or other claims which he, the contractor may have against the sub-contractor in connection with this or any other contract”

Eventually the court held that the contractor was entitled to set-off since the sub-contract was so clear. This signifies that there is no presumption of a general rule which excludes the common law right of set-off in regard to interim certificates.

IV. EMPLOYERS’ CONTRACTUAL RIGHT TO SET-OFF

Nevertheless, employers are allowed to set-off the amount claimed by relying on the express provisions in the contract.

TABLE II. EMPLOYER’S CONTRACTUAL RIGHT TO SET-OFF

Cases	Issues/Significance
<i>Token Construction Co Ltd vs Charlton Estates Ltd</i>	Employer was allowed to deduct the amount of money from interim certificates when the contract expressly gave that right.

As shown in Table II, the right to set-off amounts in the interim certificate was further illustrated in another case *Token Construction Co Ltd v Charlton Estates Ltd*. In this case, the contractors entered into a contract with the building owners on a modified prime cost contract for the erection of four blocks of flats in Regents’ Park Road. However, the contractor was in delay and the employer deducted liquidated damages, and refuse to pay the interim certificate issued by the architect which amounts to £ 16,347. Eventually the employer contended that the liquidated damage was larger than the amount in the interim certificate. Eventually, Lawson J held that:

‘If there is a provision in the contract which on its proper construction entitles a building owner to deduct damages for delay from amounts shown to be due on certificates, there is nothing in the authorities which would preclude such a deduction being made from an interim certificate’.

The court held that deductions can be made from Interim Certificates if the contract expressly gives that right.

V. SITUATIONS PERMISSIBLE FOR EMPLOYERS TO SET-OFF

In general, the employers can set-off the amount in interim certificates and use it as a basis for non-payment based on several grounds. In Malaysia, some case law has demonstrated that employers can set-off the amount in the interim certificate due to the circumstances illustrated below:

A. Situation 1: When the Contractor Failed to Follow the Specification

TABLE III. CONTRACTOR’S FAILURE TO FOLLOW EMPLOYER’S SPECIFICATION

Cases	Issues/Significance
<i>Woo Kam Seng vs Vong Tak Kong</i>	The court held that the employer is entitled to set-off the payment to contractor as the contractor was proved to fail to deliver the house according to the specification required by the employer, and damages for breach of the agreement

In the case of *Woo Kam Seng vs Vong Tak Kong*, the plaintiff- a contractor sued the defendant on a building contract for RM 5,876.62 being the sum of RM 7,000 stated in the architect's certificate less RM 1,563.38 for mosaic and wall tiles supplied (as admitted) and for RM 440 being certain other works carried out which were additional to the agreement. The defendant counterclaimed the right to set-off for building materials supplied and RM 878.08 for window grilles and gates and damages for breach of the agreement. The court held that the defendant is allowed to set-off the claim by the contractor, as the contractor was proved to fail to deliver the

house according to the specification required by the employer, and damages for breach of the agreement.

B. Situation 2: When the Contractor Failed to Complete Contract Work on Time.

TABLE IV. CONTRACTOR’S FAILURE TO COMPLETE CONTRACT WORK WITHIN TIME

Cases	Issues/Significance
<i>Mahkota Technologies Sdn Bhd vs BS Civil Engineering Sdn Bhd</i>	The Contractor failed to complete the contract work within time, and his work was shoddy .To recover the losses, the employer withhold the payment to the contractor, by claiming that the employer’s claim was in excess of the contractor’s claim. The court found that there was in fact various defective of works by the contractor, and the employer was entitled to withhold payment .

In another case of *Mahkota Technologies Sdn vs BS Civil Engineering Sdn Bhd*, The contractor entered into a sub-contract with the employer to supply and to install four units of lifts and 22 units of escalators at Plaza Putra, Alor Setar. While the contractor claimed that they were entitled to payment as they had fulfilled their contractual obligations to the satisfaction of the architect, the employer contended otherwise. They claimed that the contractor’s work was sloppy and that they failed to complete the contract work within the stipulated time. Eventually, employer filed a counterclaim to recover their losses and the amount sought was in fact in excess of the contractors' claim. The court eventually held that the employer’s right to set – off payment was clearly preserved in the contract. Various defective works were far in excess of the contractor’s claim, and thus entitled the employer to withhold payment.

C. Situation 3: When the Contractor Failed to Rectify Defects as per Instruction.

TABLE V. CONTRACTOR’S FAILURE TO RECTIFY DEFECTS AS PER INSTRUCTION

Cases	Issues/Significance
<i>Kemayan Construction Sdn Bhd vs Prestara Sdn Bhd</i>	The court eventually held that the respondent was entitled to withhold payment, as it was the contractor’s failure to rectify the defects at its own cost as per architect’s instruction

As depicted in Table V above, in the case of *Kemayan Construction Sdn Bhd vs Prestara Sdn Bhd*, the respondent had entered a contract with a contractor (the original contractor'). The court eventually held that the respondent was entitled to **withhold payment**, as it was the contractor’s failure to rectify the defects at its own cost as per architect’s instruction.

VI. EMPLOYERS’ RIGHT TO SET-OFF IN STANDARD FORM OF CONTRACT

This section will illustrate in detail the employers’ express right to set-off in three (3) standard forms of contracts namely: CIDB 2000, PAM 2006, and PWD 203 (A). Relevant law

cases will be related aligned with the clauses in the standard form of contracts to deduce and depict the magnitude of employers’ right to set-off contractors’ monetary claim in payment certificates.

A. Set-off in CIDB 2000 Standard Form of Contract

Contractor’s right in exercising suspension of work under CIDB 2000 nevertheless can be challenged by the employer with the basis that non-payment is rightful due to set-off. However, in CIDB 2000, there is no direct wording on set-off, and yet there is no express wording which precludes and negatives the right to set-off. In clause 42.10 (a) CIDB 2000, it stipulates that:

“If the Employer fails or neglects to make payment of any amount due to the contractor within the Period Honouring Certificate (unless under the terms of the contract the said interim certificate has been corrected or modified by a later interim certificate which has been issued due to correction of certificates in clause 42.4, or the employer may be empowered by the provisions of the contract either not to pay, or to make deductions from the sums shown in the certificate) , and such failure shall continue for a further 14 days from the date such amount is due for payment, then the contractor shall give notice of his intention to suspend work. If the employer shall continue to default in payment 14 days after the receipt of the notice, the contractor may suspend wholly or partly the further execution of the works, or reduce the rate of the works”

From here, this clause indicates that the employer can hold the ground of set-off (make deductions) from the sum shown in certificate as the ground for valid non-payment; however the categories for deductions are not mentioned in CIDB 2000. As been held in both cases of *Gilbert-Ash (Northern) Ltd vs Modern Engineering (Bristol) Ltd* and, there is no special rule of construction operating in building which precludes and negatives the ordinary common law right of set-off in employer. With this principle, employer still can set-off the interim certificate under CIDB 2000 with the reasons such as contractor’s failure to comply to architect’s instruction, overpayment, late delivery, and etc. Nevertheless, the case of *Mondel vs Steel* implies that the employer still remain the Common Law right to set-off. This implies that the Employer might use it as a reason to set-off an enormous amount which constitutes for his vindication for non-payment.

B. Set-off in PAM 2006 Standard Form of Contract

The right of set-off nevertheless has been incorporated in PAM 1969, and continues to be incorporated in PAM 1998, however the right is less highlighted and is only limited to what is expressly stipulated in the contract. PAM 1998 for example, the right of set-off is stated in clause 30.3(i):

“Unless otherwise expressly provided in these conditions, the Employer shall not be entitled to withhold or deduct any amount certified as due under any Architect’s certificates by reason of any claims to set – off or counterclaims or allegation of defective works, materials, or goods or for any other reasons whatsoever which he may purport to excuse him

from making payments of the amount stated to be due in an Interim Certificate.”

However in PAM 2006, the right of set-off is made clearer, with certain conditions to comply.

TABLE VI. EXPRESSIO UNIUS EST EXCLUSIO ALTERIUS PRINCIPLE

Cases	Issues/Significance
<i>Pembinaan Leow Tuck Chui & Sons Sdn Bhd vs Dr Leela's Medical Centre Sdn Bhd</i>	Regardless of the set-off right under common law, under the “ <i>expressio unius est exclusio alterius</i> ” principle, set-off principle has been extinguished whereby the inclusion of the one is the exclusion of the other, the mechanism of set off by the employer is limited to what is dictated and laid out in the PAM 2006 Contract.

As illustrated in table 6 above, the wordings of set-off in PAM 2006 have been inspired by the case of *Pembinaan Leow Tuck Chui & Sons Sdn Bhd vs Dr Leela's Medical Centre Sdn Bhd*.

In the famous case of *Pembinaan Leow Tuck Chui & Sons Sdn Bhd vs Dr Leela's Medical Centre Sdn Bhd*, Clause 30(1) of the contract provided that the architect would issue an interim progress payment certificate to the builder to be presented to the employer who would then make the payment within 21 days from the date of presentation. On 3 August 1992, the architect issued the penultimate progress payment certificate for a sum of RM433, 288.97. The employer failed to make the payment and filed a cross-claim for damages against the builder for defective work and over-valuation. The builder sued the employer and sought summary judgment under O 14 of the Rules of the High Court 1980 ('the RHC') alleging that the employer was under an obligation to pay at once the sum appearing in the certificate issued by the architect regardless of pending disputes.

In the Supreme Court, Edgar Joseph Jr.SCJ held a few critical points in this case:

- a) Whether the right of set off or counterclaim, depends upon the wording of the contract.
- b) The express enumeration of permitted set-offs in the contract could imply that the employer was limited to making deductions which fell strictly within the scope of the permitted set-offs on the basis of the *expressio unius* principle. Applying the *expressio unius* principle, the common law right of set-off had been extinguished, not expressly but by clear implication.

Hence, from this case it had shed a light whereby regardless of the set-off right under common law, under the “*expressio unius est exclusio alterius*” principle, set-off principle has been extinguished whereby the inclusion of the one is the exclusion of the other, the mechanism of set-off by the employer is limited to what is dictated and laid out in the PAM 2006 Contract. By referring to clause 30.4 PAM 2006, the employer is entitled to set-off for several grounds such as:

- a) *Failure of Contractor to comply with Architect Instruction (Clause 2.4)*

b) *Fees, levies and charges that the contractor should indemnify the employer arise from contractor's non-compliances with any laws, regulations, by-laws, terms and conditions of any appropriate authority and service provider in respect of the execution of the works and all temporary works. (Clause 4.4)*

c) *With the consent of contractor, cost of rectifying any errors arising out from any inaccurate setting out appropriately deducted by set-off by employer (Clause 5.1)*

d) *Work, materials, goods, or workmanship which is not in accordance with contract (clause 6.5)*

e) *False warranty on goods and materials (clause 14.4)*

f) *Contractor's failure to comply with the undertaking to attend to the works and defects of a minor nature. [Clause 15.3 (b), 15.3(c)]*

g) *Defects in the liability defects liability period instructed to be left by the architect with the consent of the employer (clause 15.4)*

h) *Contractor fails to rectify critical defects during defects liability period which need urgent rectification required by architect instruction within reasonable time. (Clause 15.5)*

i) *Contractor makes default in insuring or continues to insure against injury to person and loss or damage, employee's social security scheme for local workmen, compensation insurance for foreign worker. (Clause 19.5)*

j) *Default in insuring new building works (20.A.3)*

However, the employer is only allowed to set-off provided that the architect or quantity surveyor submitted their details of their assessment of such set off, and has given the contractor a written notice delivered by hand or by registered post, specifying his intention to set off the amount and the grounds on which such set-off is made. Unless expressly stated elsewhere, such written notice shall be given not later than twenty eight (28) days before any set-off is deducted from any payment by the employer

Good news for the contractor is that **the contractor can argue and disagree with the amount of set-off**. Clause 30.4 (b) continue to state that if the contractor after receipt the written notice from the employer or the architect on his behalf and wishes to dispute the amount of set-off, shall within 21 days of receipt of such written notices send to the employer delivered by hand or by registered post a statement setting out the reasons and particulars of such disagreement. And if the parties still are unable to agree on the amount of set-off within a further 21 days after the receipt of the contractor's response, either party may refer the dispute to adjudication under clause 34.1.

C. *Set-off in PWD 203 (A) Standard Form of Contract*

PWD 203 (A) Standard Form of contract, or known as “JKR standard form” is a building contract governing the agreement between the employer (commonly known as the Government) and the contractor.

However, employers' right to set-off is arguably mandated in PWD 203 (a) Standard Form of Contract. Stated in Clause 33.0,

“The Government or the S.O on its behalf shall be entitled to deduct any money owing from the contractor to the Government under this Contract from any sum which may become due or is payable by the Government to the Contractor under this contract or any other contracts to which the Government and Contractor are parties thereto. The S.O in issuing any certificate under clauses 28 and 31, shall have regard to any sum so chargeable against the Contractor, provided always that this provision shall not affect any other remedy to which the Government may be entitled for the recovery of such sums”.

TABLE VII. DEDUCTED SUM MUST BE LIQUIDATED AND ASCERTAINED

Cases	Issues/Significance
<i>Dawnays Ltd Vs FG Minter Ltd and Trollope & Colls Ltd</i>	The sum deducted must be quantified and ascertained.

This clause with the wording of “deduct any money owing...” is however open for argument whether it provides an additional right of set-off. In the famous disputable case of *Dawnays Ltd Vs FG Minter Ltd and Trollope & Colls Ltd*, the main constructors had set-off un-quantified claim for a delay caused by the nominated sub-contractors in doing steel work properly which the main constructor suffered losses. The biggest question posed in this case is whether the Main Constructor was allowed "to deduct from any money due to sub-contractors any sum which the sub-contractors are liable to pay to the constructors". Lord Denning jointly with other judges however ruled that the main constructors can only deduct quantified ascertainable sums, in favour of the subcontractors.

Aligned with this case, the nature of the wordings Clause 33.0 PWD 203(A) implies that deductions of money by the employer are however strictly on the basis of sum of money that is liquidated and ascertained, but however, it does not preclude employer's common law right in set-off.

VII. CONCLUSION

This paper has illustrated the magnitude of the employers in using their right in set-off as the basis for non-payment in relation to Common Law, CIDB 2000, PAM 2006 and PWD Form 203(A).

Under the governance of CIDB 2000 Standard Form of Contract, there is no direct wording on set-off, and what are the categories for deductions are not mentioned in CIDB 2000. However, there is no express wording which precludes and negatives the right to set-off. With this principle, employer still can set-off the interim certificate under CIDB 2000 with the reasons such as contractor's failure to comply to architect's instruction, overpayment, late delivery, and etc. Contractors need to be wary as the employers can use his common law right as his rationale to withhold payment if he

set-off an enormous amount in excess of the payment that due to the contractor.

If both the contractor and employer use PAM 2006 Standard Form of Contract as their agreement in the construction projects, the contractor can argue and disagree with the amount of set-off. The employer **shall not be entitled to exercise any set-off unless the amount has been agreed** by the contractor or the adjudicator has been issued his decision. Hence, the issue here is clearly seen whereby when the contractor suspend works due to non-payment by the employer, the employer **is hard to use “set-off”** as reasons for non-payment. Even though the employer has the common law right in set-off, however with the virtue of *“expressio unius est exclusio alterius”* as the employer must first follow the procedures set out in PAM 2006 and limited to the conditions that entitles him to set-off

Finally, if both the employer and contractor enter into an agreement by using PWD 203 (A) Standard Form of Contract, although the employer's right to set-off is cautiously enshrined in Clause 33.0, the employer need to be mindful that his basis of deduction must be liquidated, and ascertained.

With all these findings, optimistically, the wisdom from these law cases are able to shed a light for the contractors, substantiating a platform for them to understand to what extend their payment can be withheld when employers deprive their right for payment based on the allegation of set-off in relation to CIDB 2000, PAM 2006, and PWD 203 (A) Standard Form of Contract. As cash flow is the lifeline of any business, the contractor nevertheless can instigate legal procedure and proper remedy such as arbitration, adjudication, or even rightfully suspend their works against employers non-payment if they fully comprehend such set-off that constitutes of non-payment is unlawful.

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