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ENHANCING LEGAL MECHANISMS TO ADDRESS PROJECT PAYMENT ISSUES ENCOUNTERED BY SMALL AND MEDIUM- SIZED CONTRACTORS IN MALAYSIA

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Abstract

Persistent payment problems remain a significant obstacle to the financial stability of industry participants, especially small and medium-sized contractors. Initially, the Construction Industry Payment and Adjudication Act 2012 (CIPAA 2012) was introduced with the primary aim of establishing a mechanism for swift dispute resolution through adjudication, while encouraging regular and timely payments. Apart from CIPAA 2012, litigation and alternative dispute resolution (ADR) methods are also available, which are more commonly utilised and familiar to small and medium-sized contractors. Hence, this research endeavoured to explore whether CIPAA 2012 and other legal mechanisms suit the needs of small and medium-sized contractors operating in the Malaysian construction industry. This study has employed qualitative methods, specifically semi-structured interviews, as the means of data collection. These interviews were conducted with contractors who belonged in either the small category (G1-G3) or the medium-sized category (G4-G5). The findings of this study have unveiled various avenues for enhancing the current legal mechanisms. Notably, a compelling suggestion has emerged to establish a dedicated legal tribunal responsible for addressing small payment disputes. The outcomes of this research could significantly contribute to our comprehension of how CIPAA 2012 and other legal mechanisms could positively impact the capacity of small and medium-sized contractors to effectively resolve their payment-related disputes

Keywords: CIPAA 2012, construction industry, legal mechanisms, payment problems, small and medium-sized contractors, construction project

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INTRODUCTION

Construction activities in Malaysia reached a value of RM24.8 billion during the third quarter of 2021 (Department of Statistics Malaysia, 2021). In the pursuit of becoming a developed nation, it is imperative for the Malaysian government to prioritise and support the construction industry. However, despite its significance, this industry faces various challenges, one of which is the persistent issue of payment problems (Che Haron et al., 2020). Rajoo and Singh (2012) have highlighted that payment disputes, claims, and counterclaims are inevitable in the construction industry. Since the construction industry in Malaysia operates in a hierarchical structure, any payment dispute that arises at the top level can have a significant impact on the cash flow throughout the entire chain (Cheah, 2019). This situation is further exacerbated by the presence of conditional payment practices in construction contracts, which are particularly prevalent in projects involving subcontractors (Hii, 2018). These conditional payment terms, such as ‘pay-when-paid’ or ‘pay-if-paid’ clauses, meant that subcontractors will only receive payment from the main contractor, if and when they are paid by the clients. As a result, if upstream players fail to fulfil their obligation of timely payments, downstream players like the subcontractors are left to bear the burdensome and unfair consequences (Tay & Kong, 2018; Yan et al., 2023).

According to the Construction Industry Development Board (CIDB, 2018), contractors registered with the board are classified into seven grades (G1-G7) based on several factors, such as paid-up capital and tendering capacity. Kamal et al. (2012) proposed that contractors can be further categorised into small (G1-G3), medium (G4-G5), and large (G6-G7) sizes. As shown in Table 1, small-sized contractors form the majority among all registered contractors with CIDB, thus, highlighting their significant role in the construction industry and their valuable contribution to the economic growth of this country. However, these small and medium-sized contractors have not received adequate attention from the government, as the current focus still tends to favour larger listed firms (Theong et al., 2014).

To address the previously mentioned payment issues, the Construction Industry Payment and Adjudication Act 2012 (CIPAA 2012) was enacted in Malaysia to promote timely and regular payment, and to provide a mechanism for speedy dispute resolution through adjudication. Apart from CIPAA 2012, litigation and alternative dispute resolution (ADR) methods are also available, which may be more commonly utilised and familiar among small and medium-sized contractors. Hence, this research aimed to explore whether CIPAA 2012 and other legal mechanisms have benefitted the small and medium-sized contractors, with a specific focus on resolving disputes involving small amounts of payment. The findings of this study could be used to generate recommendations for enhancing the legal mechanisms that could better cater the

needs of small and medium-sized contractors in the Malaysian construction industry.

Table 1: The Numbers of Contractors Registered with CIDB Based on Sizes and Grades, as of 24 August 2023

Grade	Paid-Up Capital (RM)	Tendering Capacity (RM)	Size	Number of Contractors
G1	5,000	<200,000	Small	65,747
G2	25,000	<500,000		22,388
G3	50,000	<1,200,000		17,150
G4	150,000	<3,000,000	Medium	5,444
G5	200,000	<5,000,000		7,434
G6	500,000	<10,000,000	Large	1,956
G7	750,000	No Limit		9,451
Total				129,570

Source: CIDB (2023)

OVERVIEW OF CIPAA 2012

Due to the long-standing payment problems in the construction industry in Malaysia, statutory adjudication through CIPAA 2012 was introduced to eliminate the widespread conditional payment practices, as well as to establish a more efficient and cost-effective dispute resolution method through adjudication (Azman et al., 2013). In addition to prohibiting unfavourable conditional payment practices, Section 29 of CIPAA 2012 grants the unpaid party the right to suspend or reduce work progress, if the disputed amount remains unpaid, either partially or in full, even after receiving the adjudication decision. Section 29(4) also explicitly states that the unpaid party who suspends or slows down work or services is entitled to a fair extension of time and can claim any losses and expenses incurred. Moreover, the adjudication process can be conducted concurrently with ongoing projects, which minimises disruptions to activities (Hassan et al., 2019; Yat, 2016).

In general, the CIPAA 2012 offers a considerably quicker resolution process compared to other dispute resolution mechanisms, such as litigation and arbitration. However, despite the positive effect of CIPAA 2012 in addressing payment claims, Singh (2018) argued that the adjudication process has become more complex and has deviated from its original purpose of assisting industry participants, such as small and medium-sized contractors, consultancy firms, suppliers, and laypersons in resolving disputes. Due to the time constraints of an adjudication process, it is believed to provide rough justice, resulting in less precise adjudication decisions (Rajoo, 2016).

Other dispute resolution mechanisms

In the context of the Malaysian construction industry, apart from adjudication, other dispute resolution methods are available, such as negotiation, mediation, arbitration, litigation, and legal tribunal. Negotiation is widely acknowledged and generally recognised as a common and preferred approach for resolving disputes, owing to its directness and potential to preserve relationships between the parties involved. Negotiation is a voluntary process where the parties involved would attempt to reach a settlement without the involvement of a third party who imposes decisions (Legal Information Institute, 2021). Likewise, mediation is also a voluntary process, where a neutral and independent third party, known as a mediator, assists the two parties in finding a mutually agreeable resolution (Mishra, 2020). In Malaysia, the Mediation Act 2012 was enacted to promote mediation as an alternative dispute resolution method.

Additionally, the Arbitration Act 2005 governs arbitration processes in this country, with the Asian International Arbitration Centre (AIAC) serving as the governing body. Arbitration involves a neutral third party, the arbitrator, who decides on the dispute. However, arbitration requires a contractual provision or agreement between the parties, although there are some exceptions (Mah, 2016). Despite the availability of various alternative dispute resolution mechanisms in the construction industry, formal litigation remains a commonly used method (Derrick, 2016).

METHODOLOGY

Given the exploratory nature of this research and its focus on small and medium-sized contractors, a qualitative approach was deemed appropriate. To collect data for this research, semi-structured interviews were conducted. The snowball sampling method was also employed, whereby new interviewees were identified through referrals by the existing interviewees (Neuman, 2017). Lau (2018) discussed the importance of validating qualitative research findings to ensure their quality, precision, accuracy, and credibility. Lau (2018) further highlighted that qualitative research studies are often conducted with a small sample size, which may raise doubts regarding the generalisability of the findings. Several strategies can be used for validating qualitative data, including external auditing, thick description, peer review, and member check (Lau, 2018; Lub, 2015; Mora, 2021). For this study, member check that involved the interviewees themselves was regarded as the most suitable approach to seek their feedback and validate the findings. The interviewees, being familiar with their own experiences and dilemmas in resolving disputes, were able to provide valuable input to validate the findings and enhance the credibility of the qualitative data. The profiles of the interviewees are presented in Table 2.

Table 2: Interviewees' Profile

Interviewee Code	Years of Experience	CIDB Grade	Position Held
001	38	G5	Director
002	11	G4	Managing Director
003	23	G4	Project Director
004	10	G4	Director
005	37	G3	Managing Director
006	20	G2	Managing Director
007	15	G3	Director
008	15	G3	Senior Manager
009	25	G3	Director
010	20	G5	Finance Manager
011	3	G4	Tender Engineer
012	15	G3	Director
013	5	G5	Director
014	8	G2	Director
015	20	G3	Director CEO
016	22	G4	Director
017	9	G4	CEO
018	15	G5	General Manager
019	20	G4	Commercial Consultant

In March 2022, a total of 30,855 CIDB G1-G5 contractors were registered in the Klang Valley region (CIDB, 2022). A total of 1,118 invitations were sent via email to the members of this group, inviting them to participate in a semi-structured interview. The selection criteria for the interviewees included individuals who have faced payment problems and managerial personnel with at least 3 years of experience in the construction industry. Their contact details were obtained from the Centralised Information Management System (CIMS) on the CIDB's website, in addition to the website of their respective company. Those who accepted the email invitations were further filtered to ensure that they fulfilled the selection criteria. Subsequently, 19 individuals accepted the invitation to partake in the interview sessions. For confidentiality purposes, these interviewees were assigned unique labels in an ascending order (001–019) that corresponded to their interview date and time. All semi-structured interviews were conducted either through Zoom or telephone conversations, as the COVID-19 pandemic restrictions were in place during March and April of 2022. Table 3 lists the distribution of interviewees based on the size of their contracting businesses, thus distinguishing between small and medium-sized contractors.

Table 3: Number of Interviewees based on Size of Contractors

CIDB Grade	Contractor's Size	Number of Interviewees	Total
G1	Small	0	8
G2		2	
G3		6	
G4	Medium	7	11
G5		4	
Total			19

RESULTS AND DISCUSSION

The responses of nine (47.37%) out of 19 participants, indicated that they were unfamiliar with CIPAA 2012. Remarkably, six of these individuals belonged in the category of small-sized contractors, with four of them belonging in the grade G3 group, while the final two belonged in the grade G2 group, making them the majority within this category. Based on these statistics, small-sized contractors were found to exhibit lower levels of exposure and awareness of CIPAA 2012 compared to their medium-sized counterparts.

Conversely, interviewees who were familiar with CIPAA 2012 accounted for 52.63% of the total participants (10 out of 19 interviewees), with only five interviewees demonstrating a comprehensive understanding of CIPAA 2012, which encompassed its objectives, purpose, and potential benefits for the stakeholders in the construction industry. These interviewees have also acknowledged that CIPAA 2012 offers a relatively quicker, more cost-effective, equitable, and efficient method for resolving disputes compared to arbitration and litigation. In contrast, the remaining five interviewees who have heard of CIPAA 2012 were merely aware of its existence, but lacked a substantial understanding of its essence and how it could be advantageous to them.

The following section presents the findings of this study, as categorised into three parts: perception towards CIPAA 2012; the application of dispute resolution methods and the disputed amounts; and preference for dispute resolution methods when dealing with smaller dispute amounts.

Perception towards CIPAA 2012

The interviewees, in general, held the perception that adjudication is not a favourable option for dealing with small dispute amounts, especially for small-sized contractors. They believed that adjudication could be financially burdensome for settling small disputes. Additionally, they were concerned that opting for adjudication might not be appealing to small-sized contractors due to various reasons. Another notable concern was the potential for the adjudication decision to be challenged in court, which could further prolong the resolution

process and incur additional costs. This uncertainty and legal complexity surrounding adjudication were viewed as deterrents for smaller contractors. Furthermore, there was a recognition among the interviewees that engaging in the adjudication process could strain the relationship between contractors and the party with whom they were in dispute. These findings were derived from the following thematic analysis of the interviewees' perceptions towards CIPAA 2012.

Costly for small dispute amounts

The interviewees generally emphasised that when disputes involve amounts that exceed RM10,000.00, pursuing resolution through the Construction Industry Payment and Adjudication Act 2012 (CIPAA 2012) would be considered a viable and worthwhile option. However, a different approach is often taken when dealing with disputes involving relatively small amounts, specifically those totalling less than RM10,000.00. In such cases, small and medium-sized subcontractors tend to explore less formal means of resolution before considering CIPAA 2012. This is primarily due to the perception that investing more time and resources in navigating the CIPAA 2012 process may exceed the initial losses incurred, rendering it an unproductive endeavour for many parties. The following excerpts exemplify the emergence of this prevailing sentiment:

“I’ve calculated before. It is not worth it for disputes below RM5,000, I would rather go through negotiation. For more than RM10,000, it’s worth a shot to go through CIPAA.” (Interviewee 003)

“I have a friend who is a CIPAA consultant, he told me it’s not worth it, if the dispute amount is less than RM10k...” (Interviewee 009)

Unfair for small contractors

Larger contractors clearly hold a significant advantage in the adjudication process, as their greater resources and financial stability would substantially increase their likelihood of prevailing in a case.

“Big companies usually have a professional team of lawyers or consultants; they are more dominant in the industry and may bully the smaller subcontractors who don’t understand so much about CIPAA 2012 and take advantage of them.” (Interviewee 003)

Decision can be challenged in court

Indeed, the decision made by the adjudicator is, in practice, only temporarily binding. In connection with this, several interviewees have pointed out a significant drawback of CIPAA 2012, which was the ability to challenge the adjudicator’s decision in a court of law.

“...can be challenged in a Court of Appeal and Federal Court, and the defendant still can delay payment even with CIPAA 2012.” (Interviewee 005)

“However, the disadvantage is that it can still be subjected to high court ruling where we still end up not getting a full settlement, even if we have won the case.” (Interviewee 018)

Jeopardised relationship between the disputants

Subcontractors often encounter challenges when contemplating taking action against the main contractor, as they are inclined to preserve the relationship for the purpose of securing future projects. The following excerpt serves to depict such concerns that CIPAA 2012 might have adverse effects on the relationship between disputing parties.

“...sometimes it’s not about the money but rather about the relationship between the contract parties. I spent so much effort working for you, but you don't pay me.” (Interviewee 003)

Dispute resolution methods applied and disputed amounts

Interviewees were requested to provide additional details regarding the dispute resolution methods they have employed in addressing their payment disputes and the disputed amounts. The information gathered from their responses are summarised in the following Table 4.

Table 4: Thematic Analysis on the Dispute Resolution Method and Disputed Amount

Theme	Disputed Amounts	Interviewee’s Quotes
Send reminders / negotiation	RM 10k	“Try reminding them...” (Interviewee 014)
	RM 20k	“Negotiated with the main contractor for payment by instalment.” (Interviewee 008) “...just keep reminding and reminding...” (Interviewee 009)

Theme	Disputed Amounts	Interviewee's Quotes
	RM 50k – RM 100k	“...through negotiation with the main contractor...” (Interviewee 012) “Carry out proper discussion between parties involved. Price rate will be negotiated and agreeable in certain cases.” (Interviewee 011) “Through negotiations and proper documentations, such as site diary activities record, certifications of work...” (Interviewee 015)
	RM 250k – RM 300k	“Negotiation, keep calling and reminding the client...” (Interviewee 006) “...just keep chasing for payment...” (Interviewee 016)
	RM 500k	“...keep sending reminder through email...” (Interviewee 010) “...negotiation to delay payment for a fixed amount of time.” (Interviewee 013)
	RM 1mil	“...carry out discussions and negotiation process to understand the client's situation and also provide other ways or terms of payment.” (Interviewee 002)
Adjudication (CIPAA 2012)	RM 30k	“There was also unjustified back charge, so we ‘CIPAA them’. In the end, they did pay but we offered a certain amount of discount.” (Interviewee 004)
	RM 100k	“We sent our CIPAA 2012 consultant to go deal with them. Until the second letter, their lawyer was aware of the issue and I negotiated with the client. In the end, they paid us.” (Interviewee 003)
	RM 1mil	“...CIPAA 2012...the case was partially resolved by imposing ‘hair-cut’ initiatives, where the client only offered to pay a fraction of the amount they owed us.” (Interviewee 018)
Litigation	RM 30k	“...go to court...court gave special order for us to give a discount because we are also afraid the company who owes us money will go bankrupt.” (Interviewee 019)
Arbitration	RM 100k	“...unless it's a very serious matter, I think if there is a

Theme	Disputed Amounts	Interviewee’s Quotes
		dispute above RM 300k, then I might consider arbitration...” (Interviewee 013)
Legal tribunal	RM 10k	“Once there was a case where the client refused to pay, we asked our lawyer to issue a letter of demand for the money. Instead of paying, the client directly went to the tribunal court for consumers to complain that we didn’t do our work properly. We won the case because their accusation of us was unreasonable. Out of good will, we gave a bit of discount of around RM 1k.” (Interviewee 017)

Table 4 highlights that the majority of interviewees prefer to employ other methods, such as sending payment reminders or engaging in negotiations when faced with payment disputes, even when the disputed amount reaches as high as RM 1 million. Only a limited number of interviewees have practical experience with alternative dispute resolution methods, e.g., adjudication (three interviewees), arbitration (one interviewee), litigation (one interviewee), and legal tribunal (one interviewee). Interestingly, none of the interviewees have had any exposure to the mediation process as a means of resolving their disputes.

Preferred dispute resolution methods for small dispute amounts

This section outlines the dispute resolution methods favoured by small and medium-sized subcontractors when addressing disputes involving relatively small amounts.

Negotiation

Essentially, the consensus among the interviewees was that negotiation stands out as the simplest and most straightforward approach for resolving payment disputes. This preference for negotiation was rooted in the belief that for smaller dispute amounts, to pursue more formal dispute resolution methods would be deemed unworthwhile. The following excerpts have captured this sentiment:

“I think the easiest one is negotiation, just sit down and talk...rather than spending money to go through complicated processes. We just maybe give a discount and then, get back our owed money...only bigger contractors will go through legal processes.” (Interviewee 001)

“...negotiation... is faster, easier and cheaper...” (Interviewee 002)

“...for our contracts, usually it’s small amounts of around RM 150k, it’s not worth it to go through dispute resolution, you spend more time and more money on the legal side.” (Interviewee 012)

Mediation

Despite the absence of direct mediation experiences among the interviewees, there was a prevailing belief that the impartial nature of a mediator could potentially clarify the overall situation and facilitate the disputing parties in reaching a settlement agreement. The following relevant excerpts captured this perspective:

“...mediation...is faster, easier and cheaper...” (Interviewee 002)

“...will consider referring to mediation...which is handier and faster compared to litigation.” (Interviewee 011)

Arbitration

The interviewees held a perception that arbitration was a less complicated and faster alternative to litigation. They have also indicated that arbitration was better suited for complex disputes and situations involving a significant number of claims.

“...and arbitration, which is harder and faster compared to litigation.” (Interviewee 011)

“...probably would not occur, since most of our projects don’t have big contract amounts that may need to go through that process.” (Interviewee 016)

Legal Tribunal

While there is currently no dedicated tribunal specifically for construction disputes, one of the interviewees mentioned that a legal tribunal could potentially serve as a suitable dispute resolution method for smaller dispute amounts. This interviewee suggested that the tribunal for consumer claim could provide a cost-effective and expeditious mechanism, unless the parties opted to engage their own legal representation.

“Tribunal court is useful for very small amounts, it’s free as well, unless you hire your own lawyer. However, the one our company went to was for consumers, there is no tribunal specifically for construction.” (Interviewee 017)

ENHANCING THE LEGAL MECHANISMS

The research findings were sent back to the interviewees for member check validation through a questionnaire survey. Out of the 19 interviewees, only seven of them responded to the survey. These interviewees agreed with the research findings, which indicated a level of consensus among the participants. Their consensus provided further credibility to the research findings of enhancing legal mechanisms to positively impact the capacity of small and medium-sized contractors in resolving their payment-related disputes. Figure 1 illustrates the proposed enhancement.

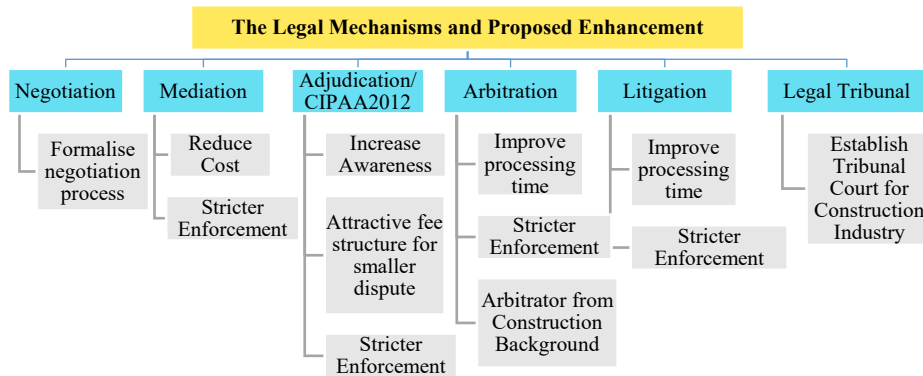


Figure 1: Proposed enhancements to the legal mechanisms

The research findings have revealed that many small and medium-sized contractors lacked the awareness and thorough understanding of CIPAA 2012. Raising the awareness of CIPAA 2012 among small and medium-sized contractors would necessitate the involvement of pertinent industry stakeholders, including the CIDB, the Master Builders Association Malaysia (MBAM), and other reputable contractors' associations in Malaysia. By collaborating with the AIAC, these entities can devise a comprehensive plan to educate contractors about CIPAA 2012. The findings also showed that CIPAA 2012 has been perceived as being financially burdensome for smaller disputes, which rendered it unattractive for small and medium-sized contractors. Hence, revising the adjudication fee structure and streamlining the process for smaller disputes could be an option. However, implementing this option necessitates a comprehensive study to ensure its appeal to both disputing parties and adjudicators, without compromising the effectiveness or integrity of the adjudication process, or infringing upon the rights of the parties involved.

The findings have also indicated that industry stakeholders have predominantly favoured negotiation as their primary method for resolving disputes. However, this approach may be susceptible to misuse by serving as a stalling tactic when one party lacks a genuine intent to resolve the dispute through negotiation due to its non-binding nature (Dani, 2020). Therefore, a legal reform aimed at formalising the negotiation process could improve its effectiveness. This recommendation aligned with the proposal by Mohd-Danuri (2021), who proposed several amendments to existing legislations that could encourage disputing parties to consider negotiation before resorting to adjudication. The suggested reform involves recognising and enforcing settlement agreements by providing robust procedures to ensure adherence to the law and its enforcement.

It is noteworthy to mention an intriguing proposal suggesting the establishment of a specialised legal tribunal designed to address small project payment claims, specifically tailored to meet the requirements of small and medium-sized contractors. This idea could also be expanded to encompass small project payment claims involving suppliers and consultants, thereby increasing its relevance and applicability. This suggestion bears resemblance to the Tribunal for Consumer Claims Malaysia, which offers specialised judicial bodies for consumers to seek redress for goods and services purchased (Courts and Tribunal Judiciaries, 2022). However, forming such a tribunal would require a comprehensive study which necessitates essential legal reform.

CONCLUSIONS

To summarise, the choice of employing CIPAA 2012 for resolving disputes within the Malaysian construction industry frequently depends on the monetary value of the dispute. In instances involving larger disputes, the advantages of being cost-effective and offering swift resolutions make adjudication a compelling option. Conversely, for smaller disputes, concerns about perceived expenses and time commitments may prompt parties to initially explore informal dispute resolution methods before contemplating more structured approaches. Numerous methods are presently accessible for addressing payment disputes within the Malaysian construction industry, encompassing negotiation, mediation, adjudication, arbitration, litigation, and the potential introduction of a legal tribunal. However, these mechanisms for dispute resolution demand ongoing enhancements to effectively address the prevailing problematic payment practices within the industry, particularly concerning small and medium-sized subcontractors. Enhancements to the legal mechanisms may also necessitate crucial legal reforms that are geared towards augmenting both justice and efficiency. The outcomes of this study have the potential to instigate further

captivating research endeavours within the realm of dispute resolution in the Malaysian construction industry.

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