

CIPAA 2012 : Prohibition of Conditional Payment Clause extends beyond Adjudication Proceedings?

SPM ENERGY SDN BHD & ANOR V MULTI DISCOVERY SDN BHD [B-02(NCvC)(W)-1669-09/2022]

28th March 2025

ISSUES

Section 35 of the Construction Industry Payment and Adjudication Act 2012 (“**CIPAA 2012**”) prohibits conditional payment clauses and such clauses are rendered void under Section 35(1) of CIPAA 2012.

There appears to be 2 lines of High Court cases on whether this prohibition only applies to adjudication proceedings or does it extend to Court and/or Arbitral proceedings. Question remains whether the prohibition extends to disputes before the Court or Arbitral Tribunal?

Further, can the employer be made liable for the main contractor’s breach of the subcontract if the main contractor is a subsidiary of the employer and is alleged to be merely a “shelf company”? Or are they entitled to arrange their corporate affairs in a manner to avoid future legal liabilities? If so, are there any proviso to such entitlement?

These questions were answered in the recent Court of Appeal case of **SPM Energy Sdn Bhd & Anor v Multi Discovery Sdn Bhd [B-02(NCvC)(W)-1669-09/2022]**.

BRIEF FACTS

The brief facts of the case are as follows:-

- (a) The 2nd Defendant was awarded a construction project known as “*Utilities, Interconnecting, Offsite (UIO) Facilities: Construction and Commissioning (CC) of 33 kV and below Distribution Substation Feeder Cable Laying, Jointing and Termination at Gas Insulated (GIS) (Rapid 1200 Project)*” (“**Project**”) by the Employer.
- (b) The 2nd Defendant then awarded the Project to the 1st Defendant.
- (c) On 12.10.2016, the 1st Defendant appointed the Plaintiff as the subcontractor for the

Project via a Letter of Award dated 12.10.2016 [**LA (1st Defendant-Plaintiff)**].

- (d) Clause 5 of the LA (1st Defendant-Plaintiff) provided that the 1st Defendant “*will make payment*” to the Plaintiff “*based on a back-to-back arrangement after receiving payment*” from the Employer.
- (e) Thereafter, the Plaintiff appointed Tiemura Engineering Sdn Bhd (“**Tiemura**”) via a letter of Award for Tiemura to perform all of the Plaintiff’s works under the Project (“**Works**”). The Plaintiff also assigned its rights to payment under the LA (1st Defendant-Plaintiff) to Tiemura.
- (f) On or about 13.02.2018, the Plaintiff informed the 1st Defendant that it intends to novate the LA (1st Defendant-Plaintiff) to Tiemura mainly due to the fact that “*the Plaintiff no longer had the capacity to finance the Project*” in view of the Plaintiff’s commitment with other on-going contracts.
- (g) Disputes then arose between the Plaintiff and the 1st Defendant where the 1st Defendant, amongst others, disagrees with the proposed novation and alleges that the Plaintiff’s works were “*below expectation*” where the 1st Defendant had to make direct payments to the Plaintiff’s subcontractors to avoid delay.
- (h) In response, the Plaintiff contends that it has paid Tiemura and its contractors, and had expended a sum estimated to exceed RM 20 million. The Plaintiff also alleged that they have not receive any payment from the 1st Defendant for the Works.
- (i) Following further exchange of correspondences, the 1st Defendant gave notice of its intention to terminate the LA (1st Defendant-Plaintiff).
- (j) The Plaintiff challenged the notice on the grounds that it was “*mala fide, premature and invalid*”. The Plaintiff also demanded for the 1st Defendant to stop making direct payments to its subcontractors and demanded for payment of the balance amount due of RM5,309,783.03.
- (k) Thereafter, the 1st Defendant terminated the LA (1st Defendant-Plaintiff) on the grounds that the Plaintiff has “no financial commitment” to pay its sub-contractors and that the Plaintiff had demobilised part of its team from the Project.

PROCEEDINGS BEFORE THE HIGH COURT

The Plaintiff initiated the suit in the High Court against the 1st and 2nd Defendant (as the parent company of the 1st Defendant) and 3 other individuals who were either the director(s) and/or shareholder(s) of the 1st or 2nd Defendant.

The claim against the 1st Defendant is premised on the 1st Defendant breaches of the LA (1st Defendant-Plaintiff), including claims for payment of the Works under the LA (1st Defendant-Plaintiff) pursuant to Clause 5 as well as for unlawful termination.

The Plaintiff also have various other heads of claims against all Defendants premised on the allegation that the Defendants committed fraud, conspiracy to commit fraud, conspiracy to injure and/or misrepresentation, resulting in losses to the Plaintiff and unjust enrichment for the Defendants. To this end, the Plaintiff claimed that the corporate veil of the 1st Defendant should be pierced to impose liability on the 2nd to 5th Defendant.

The Defendants resisted the Plaintiff's claim and counterclaimed for the 1st Defendant's losses arising from the Plaintiff's alleged abandonment of the Site.

After full trial, the High Court allowed part of the Plaintiff's claim against the 1st and 2nd Defendants and dismissed the Plaintiff's claims against the 3rd to 5th Defendants as well as the Defendant's Counterclaim.

Notably, the High Court held that the 2nd Defendant to be "*jointly and severally liable*" on the basis that the 1st Defendant is "*merely a shelf company*" for the 2nd Defendant, who used the 1st Defendant as a "*front*" to contract with the Plaintiff.

Dissatisfied with the outcome, the 1st and 2nd Defendants appealed to the Court of Appeal. The Plaintiff did not lodge any cross-appeal or appeal against the dismissal of its claims against the 3rd to 5th Defendants.

ISSUES BEFORE THE HIGH COURT

During the hearing of the Appeal, the Court of Appeal posed the following question to the Parties:-

"whether Clause 5 was valid in Court / Arbitral Proceedings pursuant to s 35(1) and (2)(a) CIPAA when there are no Adjudication Proceedings"

For context, Section 35 of CIPAA 2012 provides that:-

- "35. Prohibition of conditional payment*
- (1) Any conditional payment provision in a construction contract in relation to payment under the construction contract is void.*
 - (2) For the purposes of this section, it is a conditional payment provision when –*

- (a) *the obligation of one party to make payment is conditional upon that party having received payment from a third party; or*
- (b) *the obligation of one party to make payment is conditional upon the availability of funds or drawdown of financing facilities of that party.”*

[Emphasis added]

The Court of Appeal finds that the question is relevant to the determination of the Appeal. If Clause 5 is valid, the 1st Defendant “*was bound under Clause 5 to pay the Plaintiff for the Completed Works*” upon receipt of payment from the Employer. Any failure to do so would be a breach of Clause 5.

Conversely, if Clause 5 is invalid under Sections 35(1) and (2)(a) of CIPAA 2012, then the Court is “*duty bound to take cognizance of the Illegality (Clause 5) and cannot enforce Clause 5 in court proceedings*”.

The Court of Appeal then invited further submissions from Counsel on the question posed, as there are conflicting High Court decisions on this issue.

- **Whether Conditional Payment Clause is Void in Court / Arbitration Proceedings**

Having considered the parties’ submissions, the Court of Appeal held that Parliament intended for Section 35 of CIPAA 2012 to apply in Court or arbitral proceedings, subject to 2 exceptions.

Amongst others, the Court of Appeal held that Section 35 would apply if the 4 conditions in Section 2 of CIPAA 2012 have been fulfilled cumulatively, namely:-

- “(a) *there is a “construction contract” as understood in s 4 CIPAA;*
- “(b) *the construction contract is made in writing;*
- “(c) *the construction contract relates to “construction work” as defined in s 4 CIPAA;*
- and**
- “(d) *the construction work is carried out wholly or partly within the territory in Malaysia.*

[4 Cumulative Conditions (Section 2 CIPAA)]”

However, the Court of Appeal held that there are 2 exceptions to the applicability of Section 35 CIPAA 2012 in Court / Arbitral Proceedings, namely:-



- “(a) *the existence of circumstances as stipulated in s 3 CIPAA, i.e., a construction contract entered into by a natural person for any construction work in respect of any building which is less than four storeys high and which is wholly intended for his occupation; and*
- (b) *where a person, class of persons, contract, matter or transaction or class of contracts, matters or transactions has been exempted from the application of CIPAA under s 40 CIPAA by the “Minister” (defined in s 4 CIPAA as the Minister charged with the responsibility for works).”*

[“2 Exceptions (Non-Application of Section 35 CIPAA)”]

Having decided the above, the Court of Appeal held that Sections 35(1) and 2(a) of CIPAA 2012 invalidate Clause 5 of the Contract and the said clause is void:-

- “37. *In this case, s 35(1) and (2)(a) CIPAA apply to invalidate Clause 5 because:-*
- (1) *the 4 Cumulative Conditions (Section 2 CIPAA) had been satisfied with regard to the LA (1st Defendant-Plaintiff) and the Works in this case;*
 - (2) *the 2 Exceptions (Non-Application of Section 35 CIPAA) cannot be invoked in respect of the LA (1st Defendant-Plaintiff); and*
 - (3) *Clause 5 provided for the 1st Defendant to pay the Plaintiff after the 1st Defendant had received payment from the Employer.*
38. *Premised on the reasons as explained in the above paragraph 36 and 37, Clause 5 is void and is therefore irrelevant for the purpose of This Appeal.”*

- **Shelf Company – Piercing the Corporate Veil**

Whilst the Court of Appeal held that the 1st Defendant did not breach the LA (1st Defendant-Plaintiff) based on other findings, the Court of Appeal proceeded to examine whether the 2nd Defendant should be liable for the 1st Defendant’s breaches, assuming the 1st Defendant was held liable.

In relation to this, the Court of Appeal held that the allegation of the 1st Defendant being a shelf company, used as a front to contract with the Plaintiff, is not on its own an exception to the general rule of separate corporate personalities.

The Court of Appeal also held that the High Court had erred in not considering that the Right of Group of Companies principle for corporate arrangements as laid down in the English Court of Appeal case of **Adams & Ors v Cape Industries plc & Anor** [1990] Ch 433, which was adopted

in the Malaysian Court of Appeal case of **ARL Associates Sdn Bhd & Ors v Bank Kerjasama Rakyat Malaysia Bhd [2012] MLJU 1450:-**

“when the 2nd Defendant was awarded the Project by the Employer, the 2nd Defendant awarded the Project to the 1st Plaintiff as an exercise of the right of Group of Companies (Corporate Arrangement) by the 1st and 2nd Defendants. This exercise of the Right of Group of Companies (Corporate Arrangement) by the 1st and 2nd Defendants was lawful because the 1st and 2nd Defendants were entitled to arrange their corporate affairs in a manner as to avoid future legal liability provided that such a corporate arrangement –

(a) did not involve any actual or potential illegality; and

(b) was not intended to deprive the Plaintiff of the Plaintiff’s existing right.

The failure of the High Court to take into account the Right of Group of Companies (Corporate Arrangement) in this case, had not only undermined the General Rule (Separate Corporate Persons) but had also rendered nugatory the Right of Group of Companies (Corporate Arrangement)…”

[Emphasis added]

KEY TAKEAWAY

Following the decision, it is important to note that:-

- (a) The prohibition of conditional payment clause under Section 35 of CIPAA 2012 applies to disputes before Court / Arbitral proceedings, and is not confined to adjudication proceedings.
- (b) The prohibition would apply if the 4 Cumulative Conditions under Section 2 of CIPAA 2012 are satisfied, subject to 2 exceptions, i.e. the construction contract is not caught by the non-application proviso at Section 3 of CIPAA 2012 and that exemption by the Minister under Section 40 of CIPAA 2012 does not apply.
- (c) The main contractor being a shelf company of the employer and allegedly used as a front to contract with the subcontractor, is not on its own an exception to pierce the corporate veil. They are entitled to arrange their corporate affairs in a manner as to avoid future legal liability provided that such a corporate arrangement did not involve any actual or potential illegality and was not intended to deprive the subcontractor of its existing rights.





If you have any questions or comments on this article, please contact:-

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