

Rising Costs in Construction in Malaysia and the Recourse Available to Contractors

Contractors have always faced challenges when completing construction work, challenges that they are usually able to overcome with reasonable foresight in planning for potentially difficult circumstances. Whether it be by internal or external factors, contractors have generally been prepared for such an undertaking, but what happens when the difficulty occurs on a magnitude that the entire industry is affected by reasons outside anyone's reasonable control?

The Construction Industry has of late taken a hit due to rising costs that have greatly affected the construction process and the ability of contractors to complete their obligations without suffering huge losses.

What Caused the Rising Costs?

The COVID-19 Pandemic turned the world upside down, an event most believed would be temporary but, as of today, has lasted more than two years and the effects continue to be felt around the world.

Costs were already on the rise due to government-imposed restrictions that saw strict operating procedures being placed on project sites, the costs of which were largely forced onto contractors without any proper guidance as to whether contractors were able to claim additional costs, whether it be the actual costs incurred to comply with new requirements or the disruption costs associated with compliance.

Now, even as the world is coming to terms with the

pandemic, Malaysian contractors are facing a severe shortage in labour availability that correlates to an expected steep increase in labour costs, which most contractors will not have priced into their tenders.

As if that were not challenging enough, the Ukraine-Russia war was not in any way foreseeable and has, in part, been responsible for global price rises. Contractors who priced and submitted tenders prior to the pandemic are now facing significant increases in labour, material and fuel prices.

These unforeseen additional costs have made it virtually impossible for contractors to be able to complete their works. In many cases, the primary concern at this point is not returning a profit, but rather how to prevent the onset of bankruptcy.

Concerns of the Contractors

In such a situation of price increase, contractors will first have to consider if they are they able to claim for increased costs or are they forced to continue the work at a loss.

Contractors will need to look within their contracts and ascertain fundamental aspects such as whether the contract is a fixed price contract or whether there are specific provisions that allow for price escalation.

For the most part, since the contract price is usually fixed for the duration of the contract period, the risk of any price inflation is considered to be the contractors' and such risk is considered to include any estimated allowance for inflation under their contracts.

Standard Forms of Contract – What Do They Say About Price Escalation?

Largely, the standard forms of contract used in Malaysia are JKR,¹ PAM,² and FIDIC,³ all of which contain different wording that applies to the issue of price escalation.

For example, in the PAM Contract 2006 (With Quantities),⁴ Clause 13.1 specifically states, “The Contract Sum shall not be adjusted or altered in any way whatsoever, other than in accordance with the express provisions of the Contract.” Simply put, under PAM in the absence of a specific inclusion of an Escalation of Price Clause, the contractors would bear the risk of any price escalation.

In both PWD 203⁵ and PWD 203A,⁶ Clause 30.0 specifically states, “In accordance with the Special Provisions to the Conditions of Contract for Fluctuation of Price as contained in Appendix (if applicable), the amount payable by the Government to the Contractor upon the issue by the S.O. of an Interim Certificate under clause 28 hereof shall be increased or decreased accordingly.” Effectively, under PWD, should there be a specific inclusion for price fluctuation, then the contractors are able to claim for such.

In FIDIC,⁷ Clause 13.5 states, “In this Sub-Clause, ‘table of adjustment date’ means the completed table of adjustment data included in the Appendix to Tender.

If there is no such table of adjustment of data, this Sub-Clause shall not apply.” Essentially, under FIDIC, contractors would be entitled to fluctuations in price should they enclose a table of adjustment during the Tender Stage.

As can be seen from the various common forms of contract, the recurring theme is that the contractors essentially bear the risk of any price escalation. However, there are provisions which require additional effort during the Tender Stage to ensure the provisions for price fluctuations are included in the Appendix prior to establishing any entitlement for said costs.

Variation of Price (VOP) Clause

What is a Variation of Price Clause? It is a mechanism that may be established within a contract that allows contractors to transfer pricing risk to the employer. Subject to the specific wording of such clauses, a contractor will usually be paid on a variable rate based on market prices, taking account of fluctuations that occur both upwards and downwards during the contract period. The purpose of such clauses is to allow contractors to price their tenders safe in the knowledge that they will be reimbursed for the actual costs incurred and therefore do not need to allow for expected inflation or other such risks, while employers can expect lower Tender Prices, since the risk of price escalation is removed from the contractors.⁸

When is a contractor entitled to a Variation of Price Clause? The general application of such a clause would firstly have to be established within the contract. The courts in Malaysia have applied a strict rule of applying the express wording contained within the contract when considering contractual interpretation, thus for price escalation to apply, it would require a dedicated clause specifically providing for Variation of Price and clearly defining how the clause is to operate.

As found in the recent case of Paling Construction Sdn Bhd v The Government of Sarawak [2015],⁹ the court held that the Contractor was not allowed to claim for price fluctuations because the contract contained no Variation of Price Clause.

¹ Jabatan Kerja Raya (JKR) / Public Works Department (PWD) Form of Contract – the standard form of contract for government and public sector projects.

² Pertubuhan Akitek Malaysia (PAM) / Malaysian Institute of Architects Form of Contract – the standard form of contract for the private sector projects.

³ Fédération Internationale des Ingénieurs – Conseils (FIDIC) Form of Contract – a standard form of contract for international projects.

⁴ PAM Contract 2006 (With Quantities) - although the latest version is the PAM Contract 2018, it has yet to be widely used in the current market.

⁵ P.W.D FORM 203 (Rev. 1/2010)

⁶ P.W.D FORM 203A (Rev. 1/2010)

⁷ FIDIC Construction Contract 1st Edition (1999 Red Book)

⁸ Hudsons Building and Engineering Contracts Twelfth Editions (2010) by Atkin Chambers, pages 990-992

⁹ Paling Construction Sdn Bhd v The Government of Sarawak [2015] MLJU 810.

In simple words, no express clause; no claim.

A follow up question to the above would usually be, when will the adjustment of price take effect? It should be noted that any variation of price can only be done during the Interim Payment Certificate and not during the Final Account, which was confirmed by the Malaysian case of PBLT Sdn Bhd v Prestasi Reka Sdn Bhd & Ors [2020].¹⁰

Force Majeure?

Should a Contractor apply the Force Majeure Clause in these circumstances?

The very essence of a Force Majeure Clause is to allow relief of obligations for events beyond the control of the parties and which cannot be attributed to the fault of either party.

Essentially, it would be an event that renders a party unable to complete its obligations under the contract while bearing in mind the wording of the Clause must contain reference to the specific said event.

To claim a Force Majeure Event, and also claim costs for the same event, is inherently contradictory, because the definition of Force Majeure is an event or occurrence that cannot be blamed on either party, hence making it difficult to place responsibility on either party to bear the costs. Such Clauses effectively provide for additional time with no additional costs.

Furthermore, it should be noted that case law in Malaysia has yet to see a successful claim from a contractor for costs arising out of a claim for a Force Majeure Event.

Potential Solutions

It is evident that there is no clear-cut solution as to how to handle this current predicament. As mentioned, if there is an express Variation of Price Clause, then the contractor is safe-guarded against inflation of prices that have been submitted in the tender. However, such clauses are rare so, what are the other potential solutions for contractors?

Renegotiation of prices may be one such option. However, this would require an understanding and considerate employer who is willing to consider an increase in the price of a development, though may not be contractually obligated to do so.

Alternatively, negotiation towards a mutual termination of the contract may be another possibility if contractors are facing losses from continuing with the works. Again however, since employers will invariably face increased costs to retender the remaining project works, they may not be open to such discussions.

Employers will be mindful that the termination of a contract may not be in their best interests because any alternative contractors would be pricing their tenders at higher rates to reflect the rising costs. As the old adage goes 'what goes up must come down.' This is often the case following rapid price hikes that have come about following events that, while having a global impact, do not last forever. Employers may be well advised to consider including Variation of Price Clauses in their contracts which could well result in future reductions in tender prices as current price inflation declines and the cost of resources begin to return to pre-pandemic market levels.

¹⁰ PBLT Sdn Bhd v Prestasi Reka Sdn Bhd & Ors [2020] MLJU 2056.

The views expressed herein are those of the author(s) and not necessarily the views of FTI Consulting, Inc., its management, its subsidiaries, its affiliates, or its other professionals.

FTI Consulting, Inc., including its subsidiaries and affiliates, is a consulting firm and is not a certified public accounting firm or a law firm.

YOHANAN PALMER

Senior Consultant

Construction Solutions

+60 17 3732052

yohanan.palmer@fticonsulting.com