

Security of Payment Law: A Study of Late Payment and Non-Payment in Construction Contracts

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ABSTRACT

The late payment, withholding payment, or non-payment by the employer that there is causing the contractor does not receive any progress payment becomes due and payable because the Civil and Commercial Code: Hire of Work, Section 587 to 607, lacking specific provision to provide contractor's right to claim based on documentary research, and the freedom of contract leads to unfair contract termed drafted by the party that has bargaining power to take advantage or allocate a lot more risk to the other party in particular as existing in construction industry.

Although, the Building and Construction Industry Security of Payment Act, in Singapore, is provided that the progress payment shall be secured in construction work. The contractors and subcontractors shall be granted the rights to be paid and it must be reducing the risks¹ of the contractors and subcontractors while they encounter late payment, withholding payment, or non-payment. They will be granted the procedure to claim and entitlement to receive payment quickly to carry out the completion of work efficiency.

Based on the study of Singapore law, the result of the study found that Thailand should be introducing the Security of Payment Act to secure payments for contractors and subcontracts in construction contract including supply of goods and services or a contract for services. Therefore, the Security of Payment Act granted the right for payment claims, entitlement to make adjudication applications, and suspension of work. The late payment and non-payment may occur multiple times while the dispute resolution should be fast and effective in particular construction contract.

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¹ Vintage Engineering Public Company Ltd., Annual Report 2013, p.16.

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Introduction

A Construction industry is the main industry being a major role to economic growth in Thailand. For the past ten years, the value of investment in construction business is in a large amount and lead to higher gross domestic product (GDP) accordingly. The reasons are that the construction has a special characteristic relating to other business chains such as businesses of construction materials, real estate development, machineries, and tools manufacture including rental business, hire of those related works and employment of manpower. Construction projects in Thailand can be separated by types of project owners or employers into 2 categories; the first one is in the public sector, i.e. the government or state agencies and the second is in private sector, i.e. business proprietors. Mostly, in public sector, the government mostly aim to invest in infrastructure projects that there are large projects with high-value investment, where small and medium-sized enterprises (SMEs) are unable to meet the requirement to be a main contractor, but they will be hired to be subcontracts for several parts of project works which affect increasing of employment under those infrastructure projects.

As late payment and non-payment are practically happening which impacts the entire construction industry, they lead to cost reduction and standard construction decrease, that is contractors will use its effort to execute work upon the cost reduction in labor force, below standard materials and workmanships and others. The consequence then leads to income insecurity of labors and subcontractors and the occurrences of labor shortage appear continuously. In particular of subcontractors being SMEs, who have no bargaining power to deal with the employer in the non-payment or late payment issues, it will lead to the problems of limitation of tendering for future works to expand or develop their construction business. Moreover, construction businesses are highly competitive between building companies by which lead to under-estimated pricing to receive contract award with risks of losses at the end of the contracts or collusive bidding for contract award controlling by a few large construction companies which at present being attributable to a monopoly of the construction industry in Thailand. To secure those payments to solve the problems in construction industries that the employers practically make late payment or non-payment, there are some financial tools such as letters of

credit, bonds or bank guarantees². However, these tools are hardly accepted by employers except for international construction projects.

Regarding laws applied to construction contracts in Thailand, there are two main contracts based on the status of the owners or the employers i.e.: governmental contracts and private contracts. At present, a governmental construction contract form and other related contract are provided by the Regulation of Public Procurement and Supplies Administration Act, A.D.2017 under the Notification of the Policy Committee in charge of Public Procurement and Supplies Administration and parts of them are administrative contracts which are under the Act Establishing Administrative Courts and Administrative Courts Procedure, A.D.1999 and the jurisdiction of Administrative Court. The laws governing the rights and obligations among parties of the administrative contracts are not applied to private construction contracts. The private contracts are subject to the Civil and Commercial Code on part of general contract laws and the law regarding Hire of Works³ which was designed for general hire of work contracts but not specifically for construction contracts. Those laws are purposed for general hire of works which at this moment are unable to cope with complicated work under construction contracts which have been developed into the construction industry for medium and large construction projects. It can be concluded that Thailand has no specific law which establishes a specific legal measure and procedure to secure payments and remedies for construction industries as implemented in some developed countries which resulted in sustainability to construction industries.

All above-mentioned facts evidence the result of no effective law or legal procedure in Thai legal system to secure contractors or subcontractor's rights to remedies against the employers or to enforce the employers to pay for actual work done by them within a reasonable time. This results in a hindrance to developing of the construction business to be a stable and better standard for all who were involved in the industry. Law to secure payments for construction contract was first established in Great Britain. Lack of specified security of payment law may affect construction contract, there is no procedures to facilitate payment for contractors or subcontractors who invested in the construction project. In addition, the right of contractors or subcontractors is often not stipulated in a governmental and private construction contract in Thailand. They are unavoidable enter into unfair contract terms, if they have been awarded. The Security of Payment Act will

² Alex Guy and Kate Papailou, "Performance Security: Bonds, Guarantees and Letters of Credit," DLA Piper, Asia Pacific Projects Update.

³ Civil and Commercial Code: Book 3, Title VII: Hire of Work.

cover all types of construction contracts to ensure the contractors and subcontractors cash flow by granted the right to receive payment, even in dispute resolution procedure.

The Security of Payment Act is provided to reduce the risks of contractors and subcontractors while they encounter late payment or non-payment. They will be granted the procedure to claim and entitlement to receive payment quickly to carry out the completion of work efficiency. Finally, Thailand should enact the Security of Payment Act in similar to other countries specifically as in Singapore that have thoroughly studied and researched that the contractors and subcontracts will be benefit from the procedure of adjudication to adjudicate the amount for fairness and faster than before the Security of Payment Act was enacted. The late payment and non-payment may occur multiple times while the dispute resolution should be fast and effective in particular construction contract.

Methods

The methodology of this article is documentary research which focusing on the Security of Payment in case of Late Payment and Non-Payment, and compiling information from different sources such as legal textbooks, legal articles, theses, research papers, provisions, regulations, and other related documents in order to reach the comparative laws in Construction Contracts between Thailand and Singapore.

Literature Review

Construction projects in Thailand have two contract models based on the type of payments⁴. The first one is a lump sum contract upon which the contractor is responsible to complete the project under a fixed total cost including material and labor costs, management cost, overhead and profit, tax and etc. The second one is a measurement contract (or re-measurement contract) where the contractor shall complete the project in compliance with drawings and specifications under an estimate total price whereby the contract shall provide unit rates in the bill of quantities for several items of works which the actual amount to be paid for the total works will be determined by a method of

⁴ Designing Buildings Limited, “Different Between Lump Sum and Measurement Contracts,” at https://www.designingbuildings.co.uk/wiki/Difference_between_lump_sum_and_measurement_contracts, (last Visited 17 December 2019).

measurement for the actual work carried out and calculated by the rates provided. In addition, the payment terms of those construction contracts are much more complicated than other contracts. If late payment or non-payment has been made, it absolutely impacts the contractor's cash flow and result in consequence loss to subcontractors who are entrusted to complete several parts of the contract work due to the various type of works included in construction.

The late payment and non-payment of the employer will affect huge impact to construction company. Some companies no longer are able to bear the burden of its financial difficulties then collapse and become liquidation and insolvency. The construction contract is a contract which involves many other contracts in the project because it cannot complete the whole works in the project solely by itself. If the contractor does not receive a payment in due time, it will result in all supply chain or other related services and labors. Late payment and non-payment have caused problems during the work which may affect the project delay in completion within contract completion date and unable to handover the work. As a result of the contractor is in breach of the contract and the employer has the right to claim for penalty or liquidated damages under Civil and Commercial Code Section 380-381 at the rate specified in the contract until completion and handover of project. The delay bounces back to further more delay in payment, longer withholding, or finally to non-payment.

Construction contract should be specific and suitable manner directly because there must be clarify detailed and cover all aspects, it will reduce and solve the advantageous of the parties. If a contract is ambiguous, it means that the parties have a question or doubt in a general or particular condition, word, or definition because of vague or unclear. Then, unfair issues can happen such as change in drawing, variation, suspension, penalty, termination of the contract, non-payment and etc. The importance reason of the parties is construed the contract condition for more benefit themselves than fairly, the court litigation happened. The relevant law enforcement in construction field according to the Civil and Commercial Code on part of general contract laws and the law regarding Hire of Works Section 587⁵ to Section 607, are insufficient to cover the detail of construction work in this time from the aforementioned. Other matters will be implemented by juristic act and contract law. No provision provides that the contract is

⁵ Civil and Commercial Code, Section 587 "A hire of work is a contract whereby a person, called the contractor, agrees to accomplish a definite work for another person, called the employer, who agrees to pay him a remuneration of the result of work."

to be in writing for its effect and binding. The law means to apply to all kinds of works being hired or services provided under the contract until accomplishment of such works or services. The works can even be a very small contract such as taxi services, dressmaking, car fixing or a large contract of project construction contract with several billion-baht value. It is not a specific law provided for industrial construction which have high value and huge responsibility with complicated technology and complex works under the contracts.

It seems that the law of hire of works mostly provides obligations on part of the contractors regarding the nature of general works and services such as to provide tools or instruments which are necessary for the execution of the work; to supply material in good quality if agreed to supply goods; use materials carefully and without waste if agrees to supply by the employer and return the surplus after work is completed; including liability and limitation for the contractors. The obligation on part of the employer is provided in the law of hire of work only regarding payment for work⁶ that the remuneration is payable on taking delivery of the work. If the work is to be accepted in parts and the remuneration has been specified for the several parts, the remuneration for each part is payable at the time of its acceptance. It seems that mostly the law provided the employer's right to enforce the contractor such as:

(a) to withhold payment in case of contractor's delay in delivery or of delivery of a defective work⁷; and

(b) to terminate the contract in case that the contractor does not begin to work in a proper time or delays in proceeding with it contrary to the terms of the contract, or if, without the fault of the employer, the contractor delays to proceed with it in a such a manner that it can be foreseen that the work will not be finished within the agreed period⁸.

⁶ Civil and Commercial Code, Section 602 "The remuneration is payable on taking delivery of the work. If the work is to be accepted in parts and the remuneration has been specified for the several parts, the remuneration for each part is payable at the time of its acceptance."

⁷ Civil and Commercial Code, Section 599 "In case of delay in delivery or of delivery of a defective work, the employer is entitled to withhold the remuneration unless the contractor gives proper security."

⁸ Civil and Commercial Code, Section 593 "If the contractor does not begin to work in a proper time or delays in proceeding with it contrary to the terms of the contract, or if, without the fault of the employer, he delays to proceed with it in a such a manner

No specific provision of this law provides for the contractor to enforce the employer for delay payment, withholding payment or neglect to pay. Therefore, if an employer delays or refuses to pay remuneration to the contractor as agreed in the contract, where generally being called as “progress payment”, in construction contracts, the first issue is to be consider whether the employer is entitled to do so by the aforesaid law or by any contract conditions.

Moreover, the doctrine which states that people have the right to legally bind them is known as freedom of contract⁹ including general contracts and hire of work in Thailand, and restricted scope with reasonable caused under the Civil and Commercial Code Section 150¹⁰ and Section 151¹¹. The parties are freedom to enter into contract with whoever, a person or a company, and any purpose or formation of the contract in verbal or writing. Moreover, the parties are freedom to express or stipulate the contract condition by the law principle “Pacta Sunt Servanda”.¹² A construction contract shall be applied by Hire of Work under Civil and Commercial Code where the contractor agreed to complete work and the employer agreed to make payment on accepted amount. It means that the contract is a reciprocal contract under Section 369, then either party have an obligation to follow the terms and conditions with the principle of freedom of contract for expressing and stipulating the contract conditions subject to requirement of good faith and public order or good moral. If the employer does not pay interim money when become due and payable, the contractor may issue a request for payment before the entitlement of termination contract. The request may be disputed and counterclaimed for

that it can be foreseen that the work will not be finished within the agreed period. The employer is entitled to cancel the contract without waiting for the time agreed upon for delivery.”

⁹ Pimvimol Vipamaneerut, John King, and David Duncan, Bangkok, Thailand, “Restrictive Covenants: Laws and Types of Restrictions, ” Tilleke & Gibbins International Ltd.

¹⁰ Civil and Commercial Code, Section 150 “An act is void if its object is expressly prohibited by law or is impossible, or is contrary to public order or good morals.”

¹¹ Civil and Commercial Code, Section 151 “An act is not void on account of its differing from a provision of any law if such law does not relate to public order or good morals.”

¹² International Judicial Monitor, “General Principles of International Law,” PactaSuntServanda, at www.judicialmonitor.org/archive_0908/generalprinciples.html.

the penalty and liquidated damages. There are two channels of dispute resolution in Thai Law, the first one is court of justice under the law of organization of the court of justice and the second one is arbitration under the Arbitration Act A.D.2002.

Results

This article found that Singapore Law establishes the Building and Construction Industry Security of Payment Act 2004 (“SOP Act”) to apply both public contracts for construction and private construction contracts, means construction contract and supply contract including contract that has been terminated, to facilitate payments for work done by contractor and subcontractor and secure to receive payment. The employer cannot allege unreasonable issues to withhold or deducted any payments arbitrarily and unfairly. As a matter of fact, the contractor and subcontractor have less bargaining power and are unavoidable to maintain business relationship for future projects. SOP Act is able to maintain fairness through payment security provisions with the provision of “No contracting out” in Section 36 which stipulates that any terms and condition in an agreement related to construction being applied by the Act if exclude, modify, restrict or prejudice to the operation of the Act shall be void. In conclusion, upon SOP Act, the employer shall be enforced to comply with the act without limitation whether it is a public contract or private contract. In addition, during the period of construction, the contractor may serve a payment claim under Section 10 in respect of progress payment in whole or in part which has not been paid to the employer who is or may be liable to make payment under the contract, then the employer shall respond to the payment claim by a payment response with reason and information stating response amount to pay the claim amount in whole or in part or raising objection. If the claim has not been paid, the contractor has right to notify the employer in writing of his intention to apply for adjudication of the payment claim dispute. In addition, Section 9 “pay when paid”¹³ clause provides that payment to the subcontractor to be conditional upon the main contractor receiving payment under the main contract, shall be unenforceable and no effect. Thus, that clause has no effect to bar the subcontractor to raise the dispute for adjudication.

¹³ Singapore Law Watch, “Ch.26 Building and Construction Law,” Pay When Paid Provisions, at <https://www.singaporelawwatch.sg/Headlines/ch-26-building-and-construction-law>

However, in Singapore the Security of Payment Act had been proposed to grant the right of payment claims for contractors and subcontractors, and establish the procedure for payment claims under Section 10 for late payment or non-payment. The employer must be paid in whole or in part to response the payment claim Section 11 before a party intends to make adjudication applications Section 13. Moreover, the act regulated pay when paid provision to be unenforceable and no effect, which is a major disadvantage to every tier of subcontractors or suppliers and results in cash flow difficulties in construction industry.

Conclusion and Recommendations

The Security of Payment Act has provided similarly safeguard conditions to “pay when paid” and “no contracting out” clauses to prevent the general principle of law which permits contracts to be drafted in contrary to provisions provided by law if not conflict to public order or good morals and being enforceable. The freedom of contract leads to unfair contract termed drafted by the party that has more bargaining power to take advantage or allocate a lot more risk to the other party in particular as existing in construction industry. For the reason, to maintain fairness Section 9 provided that “pay when paid” which provided in the contract is unacceptable and being unenforceable and having no effect and Section 36 “no contracting out” which stipulates that any terms and condition in an agreement related to construction being applied by the Act if exclude, modify, restrict or prejudice to the operation of the Act shall be void.

Therefore, the existing of Security of Payment Act can facilitate payments for contractors and subcontractors in construction contract including supply of goods and services or a contract for services, by granting the right for payment claims, entitlement to make adjudication applications under a quick process, and enforcement procedure by suspension of work.

As a result, Thailand should be introducing the Security of Payment, Act for both of governmental contract and private contract according to the objective of Security of Payment in Singapore which was modelled substantially on the Building and Construction Industry Security of Payment Act of the New South Wales legislation under the same desire to improve payment behavior within the construction industry for sixteen years, the contract law still respects the doctrine of freedom of contract or liberty of contract subject to requirement of good faith and public interest or good moral, to establish the committee similar to authorized nominating body to judge the dispute in

adjudication process that faster and appropriate more than arbitration because focusing on payments in construction work in the meaning of the act. Finally, begin to observe and survey the result of implementation of the act, the contractor and subcontractor feedbacks on the understanding and beneficiary of the purpose of the act as facilitate payments for construction work done or related goods or services supplied including the dispute resolution by adjudication. However, the act must be proposing and amending from time to time¹⁴, to be proper law for the practice of the country.

¹⁴ Singapore Academy of Law, “Proposals for Amending the Building and Construction Industry Security of Payment Act”, (Law Reform Committee, published, September 2015).

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