

Client Alert

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Are Retention Sums trust monies belonging to a contractor?

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Retention monies are monies withheld by the employer from the sum otherwise certifiable to the contractor. It generally serves as a safeguard against the possibility of the contractor's failure to complete the works and against defective works.

Assume that the employer was wound up. Should retention monies be returned to the main contractor as trust monies or is this money due and owing (i.e. potentially lost to the main contractor, forming part of the monies to be distributed *pari passu* in the winding up with the main contractor being an unsecured creditor)?

This was subject to conflicting Court of Appeal decisions in *Qimonda* (which held that there was a trust) and *Geohan* (which decided otherwise). The Federal Court in *SK M&E Bersekutu Sdn Bhd v Pembinaan Lagenda Unggul Sdn Bhd (in liquidation)*¹ heard together with *Geohan Sdn Bhd v Pembinaan Lagenda Unggul Sdn Bhd (in liquidation)*² followed the *Geohan* line of thought.

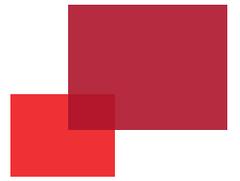
The Federal Court took the view that 3 essential features to form a trust must be present i.e. (a) certainty of words; (b) certainty of subject; and (c) certainty of object. Here, the contractual terms merely provided for the first moiety of the retention monies to be returned in the event of CPC and the second moiety upon DLP/CGMD. There were no contractual words or conduct of the parties suggesting a trust, and the monies were not segregated.

Accordingly:

- a) By law, retention monies are not held in trust by the employer for the benefit of the contractor;
- b) It is a matter of construction (interpretation of contract) whether or not the retention is to be held in trust by the employer for the benefit of the contractor;

¹ Appeal No. 02(f)-130-11/2017(W).

² Appeal No. 02(f)-131-11/2017(W).



- c) Retention monies cannot be held to exist in trust without the employer first appropriating and setting aside the money as a separate trust fund.

In light of the Federal Court's judgment, contractors and subcontractors are now at risk in the event of the employers going into liquidation since they are now considered unsecured creditors. This risk was acknowledged by the Federal Court who considered that this could be dealt with by way of reforms, similar to those in New Zealand and Australia. Solutions include enacting legislation enabling retention sums to be placed in authorised deposit-taking institutions or to legislate that retention sums should be deemed as trust monies.

