

**Thirtieth Meeting of
the Business Facilitation Advisory Committee**

***Agenda Item 2 : Proposed Security of Payment Legislation
for the Construction Industry***

Purpose

This paper briefs members on the proposed Security of Payment Legislation for the Construction Industry (SOPL).

Background

2. The Development Bureau (DEVB) and the Construction Industry Council conducted an industry wide survey on payment practice in the local construction industry in 2011 (DEVB Survey)¹. The survey revealed significant payment problems being experienced by main contractors, sub-contractors, consultants and suppliers. Particular problems included the use of 'pay when paid' clauses and payments being delayed by disputes. Payment problems were more severe in the private sector. Administrative and contractual arrangements on public works contracts alone cannot help resolve the problems of the wider industry. DEVB therefore considers it necessary to adopt a legislative approach to address payment issues.

3. In September 2012, DEVB appointed a consultant to study and advise on the models of SOPL adopted in overseas jurisdictions and on options and issues for the introduction of similar legislation in Hong Kong.

4. In October 2012, DEVB set up a Working Group on Security of Payment Legislation for the Construction Industry (Working Group) comprising representatives of key industry bodies in Hong Kong and solicited, among others, their views and comments on the essential elements and framework of the legislative proposal. The membership of the Working Group is at **Annex 1**. The Working Group discussed the options and issues

¹ The Survey on Payment Practice in the Construction Industry Executive Summary has been uploaded to the DEVB website at http://www.devb.gov.hk/filemanager/en/content_31/Survey_on_Payment_Practice_in_the_Construction_Industry_Executive_Summary.pdf

for the proposed legislation identified by the consultant under the following broad headings –

- scope of coverage;
- payment;
- prohibition of ‘Pay when Paid’ and conditional payment;
- suspension for non-payment; and
- adjudication and enforcement.

5. After thorough studies and making reference to overseas practices, the Working Group recommended to legislate on security of payment in the industry. The legislative framework of SOPL is briefly described below.

Legislative framework of SOPL

Scope of coverage

6. SOPL will apply where construction works, consultancy services or plant and materials are being supplied for works in Hong Kong. Coverage will be different in the public and private sectors.

7. In the public sector, SOPL will cover all construction contracts, consultancy appointments, supply contracts and sub-contracts procured by the Government and specified statutory and/or public bodies and corporations regardless of value. The SOPL will hence be applicable to all construction activities and maintenance, repairs and renovation in the public sector. Installation of fixtures and fittings such as air conditioning and security systems will also be included. The proposed list of specified statutory and/or public bodies and corporations is at **Annex 2**.

8. In the private sector, SOPL will cover construction contracts, consultancy appointments, supply contracts and sub-contracts relating to a “new building” as defined by the Building Ordinance (Cap 123) where the main contract has an original value in excess of HK\$5 million or where the original contract value of consultancy appointments and supply only contracts is in excess of HK\$0.5 million. When drawing up the scope of SOPL for the private sector, we particularly take note of the fact that private property owners, incorporated owners and small to medium enterprises may not have better experience and knowledge in managing construction contracts and may not have ample knowledge to assess the necessity and reasonableness of the cost of the works. Therefore private sector restoration,

maintenance and repair works and new works below the value of \$5 million are proposed to be excluded from the scope of SOPL in order not to overburden them with legal liabilities.

9. Where a main contract is subject to SOPL, all lower tier sub-contracts are proposed to be subject to SOPL.

10. In Hong Kong, smaller contractors and sub-contractors who most need the protection of SOPL are the parties most likely to be working on the basis of oral or partly oral agreements. As such, it is proposed that SOPL will apply to both written and oral contracts.

Payment

11. Contract parties will remain free to agree in their contracts with respect to payment intervals. Parties will also remain free to agree how work is to be valued and paid for. For instance, there is no proposed limitation on using rates, fixed prices, target cost, cost reimbursement and other payment/risk models.

12. Once payments become due, the maximum time period upon the SOPL coming into effect that may be agreed for payments shall be 60 calendar days for progress payments and 120 calendar days for final payments so as to support and promote efficient cash flow down the contractual chain. As compared to current trade practice, these maximum periods allowed are slightly longer than the periods typically provided for in most current Hong Kong contracts.

13. Where parties do not make express agreements as to when payments are to be claimed and/or how they are calculated and/or when and how the paying party shall respond to payment claims and/or when payment shall be made, the following will be adopted through the SOPL's provisions –

- Parties undertaking work or providing services, materials or plant will be entitled to make payment claims at calendar month payment intervals.
- The payment due will be calculated based on the value of work, services, materials or plant provided and valuation will be based on any relevant contract price or pricing or in the absence of the same on market rates prevailing at the time the contract was entered into.

- Paying parties will be entitled to serve a payment response within 30 calendar days of receiving a payment claim.
- The payment period shall be 60 calendar days (for interim payments) or 120 calendar days (for final payment) after receipt of a payment claim.

“Pay when paid” clauses

14. In the current practice, some payers rely on “pay when paid” clauses to deny payment to a party which has undertaken work or provided services on the basis that the payer has not yet received payment under his own contract.

15. “Pay when paid” has long been regarded as an unfair block to cash flow which has the potential to harm smaller sub-contractors and traders who are generally the parties least able to fund and withstand significant delays in payment. The DEVB Survey confirms that, especially on private sector works projects, sub-contractors, consultants and suppliers all suffer from the withholding of payment due to “pay when paid”.

16. SOPL will render “pay when paid” clauses ineffective.

Right to suspension on non-payment

17. Also, in the current practice, unpaid parties may be contractually obliged to continue performing and funding their work increasing the financial pressure and risks they face. Under the common law, it is only open to them to exercise termination provisions in their contracts (if any) or to treat non-payment as a breach of contract which is serious enough to amount to repudiation at common law.

18. It is proposed that SOPL will introduce a right for parties to suspend all or part of the works or reduce the rate of progress in the event of non-payment. Parties which suspend or slow down the rate of progress for non-payment will have rights to additional time to complete their obligations and to reasonable costs and expenses in respect of delay and disruption arising from the suspension.

19. Unpaid parties must however serve a written notice of their intention to suspend to the non-paying party and (if known) to any party

which pays the non-paying party (the “principal”) and to the site owner. Such notices of intention to suspend may, in many cases, be enough to prompt paying parties to comply with their obligations. Besides, owners or principals may be able to take action to promote expeditious resolution of the payment dispute, or if they are unable to prevent a suspension occurring, they may be able to manage the remaining works so as to minimise adverse effects.

Adjudication and enforcement

20. SOPL also provides a statutory right to adjudication. It is intended that the procedure should be far more rapid and cost effective than court arbitration.

21. Under SOPL, parties to a contract will be entitled to refer disputes to adjudication subject to disputes concerning the following –

- the value of work, services, materials and plant supplied and claimed in a payment claim; and/or
- other money claims made in accordance with any provision of the contract and claimed in a payment claim; and/or
- set offs and deductions against amounts due under payment claims; and/or
- the time for performance or entitlement to extension of time for performance of works or services or supply of materials or plant under the contract.

22. The proposed adjudication will encompass the following key features –

- The claiming party shall commence adjudication by serving on the other party a notice of adjudication, setting out details of the parties, the nature of the dispute and the redress sought within 28 calendar days from the arising of the dispute.
- An adjudicator is to be appointed by agreement or by nomination from an agreed nominating body or (if none) by Hong Kong International Arbitration Centre within 5 working days of commencement.

- The claiming party shall serve his submission together with all supporting evidence (which may include documents, photographs, witness statements and expert reports) on the responding party on or before the date of appointment of the adjudicator and on the adjudicator on the day of his appointment or the next working day.
- The responding party is allowed 20 working days from receipt of the claiming party's submission to respond with his own submission and supporting evidence.
- The adjudicator shall then reach and publish his decision, with reasons, within 20 working days of receipt of the responding party's submission extendable by the adjudicator up to 55 working days from the date of appointment of the adjudicator and to in excess of 55 working days if both parties agree.
- Each party shall bear its own legal costs of the adjudication but the adjudicator may decide which party pays the adjudicator's fees and expenses or the proportions in which they are to be jointly paid by the parties.

23. Any contract party not satisfying with the results of adjudication may refer the dispute(s) concerned to court or arbitration (if provided for in the contract) but any amount decided by the adjudicator shall remain binding until the outcome of the court proceeding or arbitration is available.

Public consultation

24. DEVB launched a 3-month public consultation on 1 June 2015 ending on 31 August 2015². In this period, DEVB hosted 4 consultation forums in July and August 2015 and made briefings and presentations to the relevant professional institutions, trade associations and unions.

Way forward

25. DEVB is analysing the consultation responses and has started conducting the Business Impact Assessment on SOPL. We plan to start the drafting of the proposed bill in 2016.

² The public consultation document was uploaded to the DEVB website at http://www.devb.gov.hk/en/publications_and_press_releases/Consultation_Papers_Reports/sop/index.html

26. Members are requested to note the content of the paper and offer comments, if any.

Development Bureau
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Membership of the Working Group on Security of Payment Legislation

The Association of Architectural Practices

The Association of Consulting Engineers of Hong Kong

Construction Industry Council

Development Bureau

Hong Kong Construction Sub-Contractors Association

The Hong Kong Institute of Architects

The Hong Kong Institution of Engineers

Hong Kong International Arbitration Centre

Hong Kong Housing Authority

MTR Corporation Limited

The Chartered Institution of Civil Engineering Surveyors

The Hong Kong Construction Association Limited

The Hong Kong Federation of Electrical and Mechanical Contractors Limited

The Hong Kong Institute of Surveyors

The Real Estate Developers Association of Hong Kong

Specified statutory and/or public bodies and corporations under SOPL

1. Airport Authority
2. CLP Power Hong Kong Limited
3. Chinese University of Hong Kong
4. City University of Hong Kong
5. Construction Industry Council
6. Hong Kong Academy of Medicine
7. Hong Kong Academy of Performing Arts
8. Hong Kong Baptist University
9. Hong Kong and China Gas Company Limited
10. Hong Kong Electric Company, Limited (Hong Kong Electric Investments)
11. Hong Kong Institute of Education
12. Hong Kong International Theme Parks Limited
13. Hong Kong Polytechnic University
14. Hong Kong Productivity Council
15. Hong Kong Science and Technology Parks Corporation
16. Hong Kong Sports Institute Limited
17. Hong Kong Trade Development Council
18. Hong Kong Tramways Limited
19. Hong Kong University of Science and Technology
20. Hospital Authority
21. Housing Authority
22. Housing Society
23. Kowloon-Canton Railway Corporation
24. Lingnan University
25. MTR Corporation Limited
26. Ocean Park Corporation
27. Open University of Hong Kong
28. University of Hong Kong
29. Urban Renewal Authority
30. Vocational Training Council
31. West Kowloon Cultural District Authority