



Proposed Security of Payment Legislation for the
Construction Industry

Summary and Guide



發展局
Development Bureau

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Introduction

The Development Bureau of the Government of Hong Kong Special Administrative Region is consulting on important new legislation for the construction industry known as Security of Payment Legislation.

For full details and to comment on the proposals please access the Consultation Document at www.devb.gov.hk/sop. Hard copies are available at District Offices.

Why is Security of Payment Legislation (“SOPL”) being proposed for the construction industry?

A detailed industry wide survey was conducted in 2011 by the Government and the Construction Industry Council. It found that unfair payment terms, payment delays and disputes were causing widespread cash flow problems. Contractors, sub-contractors, suppliers and consultants were all affected.

SOPL encourages fair payment and rapid dispute resolution and increases cash flow. It also provides a simple mechanism for paying parties to challenge incorrect claims for payment. Since 1996, SOPL has been introduced in the United Kingdom, Australia, New Zealand, Singapore, Malaysia and Ireland.

How has the proposed SOPL been created?

A Working Group was formed comprising key construction industry stakeholders and Government representatives. The Working Group considered different SOPL practices in other countries and the best approach for local conditions in Hong Kong.

SOPL enhances cash flow by providing a simple process for claiming payments, responding to claims and resolving disputes.

Which contracts will be covered by SOPL?

SOPL will apply to written and oral contracts. It will apply where construction works, consultancy services or plant and materials are being supplied for works in Hong Kong. It will apply even where the law of the contract is not Hong Kong law. Coverage will be different in the public and private sectors.

- **Public Sector** – All construction contracts, consultancy appointments, supply contracts and sub-contracts for Government works will be covered regardless of value. Relevant works will include virtually all construction activities and maintenance, repair and renovation. Installation of fixtures and fittings such as air conditioning and security systems will also be included. Works procured by specified statutory and/or public bodies and corporations will also be covered. These are listed at Schedule 1 of this document.
- **Private Sector** – SOPL will only cover construction contracts, consultancy appointments, supply contracts and sub-contracts relating to a “new building” as defined by the Building Ordinance (Cap 123). SOPL will only apply where the main contract for the new building has an original value in excess of HK\$5 million (the limit will be HK\$0.5 million for consultancy appointments and supply only contracts). When SOPL applies to the main contract then it will also apply to all sub-contracts. Where SOPL does not apply to the main contract, it will not apply to the sub-contracts.

The approach to private sector coverage means that:

- The majority of individuals and small businesses procuring routine construction works will be unaffected by SOPL.
- SOPL will not apply to the private sector procuring maintenance, repair, renovation and restoration works.
- Individuals and businesses will only be affected if they procure a new home, premises or other new build works over the HK\$5 million threshold.

SOPL will apply to all contracts and sub-contracts for public sector works including maintenance and renovation.

In the private sector, SOPL will only apply to individuals, businesses and Incorporated Owners when they procure new buildings at a cost over HK\$5 million or related consultancy services costing over HK\$0.5 million. Private sector repair, maintenance and renovation will not be covered.

Removing unfair payment terms from the industry

Parties will remain free to agree when claims for payment can be made for works, services or supplies. Parties will also be free to agree how payments are valued. However, SOPL will prohibit fundamentally unfair payment practices:

- 'Pay when paid' and similar clauses in contracts will be unenforceable. Payers will not be able to rely on such clauses in court, arbitration or adjudication to avoid making payments.
- Payment periods of more than 60 calendar days (interim payments) or 120 calendar days (final payments) after a claim can be made will be unenforceable. If a contract specified longer payment periods, the courts, arbitrators and adjudicators would adopt 60 or 120 calendar days.

Rights to make statutory Payment Claims

SOPL will help increase contractual certainty and identify quickly whether claims for payment are admitted or disputed:

- Amounts due for construction work, consultancy services, materials or plant supplies can be claimed as statutory 'Payment Claims'. Where contracts provide for payment of delay and disruption related costs, these can be included in Payment Claims.
- Upon receipt of a statutory Payment Claim, the paying party will have up to 30 calendar days to serve a Payment Response. The payer should identify what is admitted, what is disputed and whether any amounts will be set off against what is due.
- A party can ask an adjudicator to decide what has to be paid against a statutory Payment Claim if:
 - A Payment Response disputes all or part of the Payment Claim.
 - A Payment Response states that the paying party intends to set off a claim of their own against the Payment Claim.
 - No Payment Response is served and/or no payment is made.

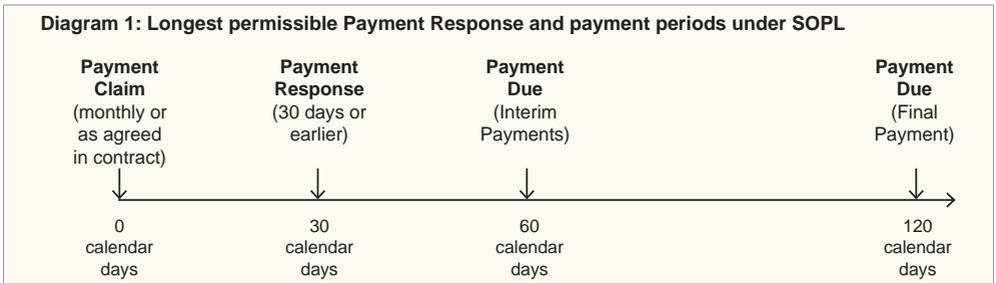
'Pay when Paid' clauses will be unenforceable.

Paying parties cannot impose unreasonably long payment periods. Once a claim can be made, any amount due must be paid no later than 60 calendar days (interim payments) or 120 calendar days (final payments).

- Payers will have the right to defend Payment Claims in adjudication by arguing that amounts claimed are not due. For example, it might be argued that under the terms of the contract nothing is due or that wrong rates or quantities have been used. Arguments like these can be raised in adjudication even if no Payment Response was served. However, no set off may be raised in adjudication unless details were provided in a timely Payment Response.
- If parties do not agree expressly in their contracts how payments can be claimed then SOPL will apply default terms. SOPL default terms allow Payment Claims to be submitted monthly for the value of works provided. Payment Responses must be served no later than 30 calendar days after. Payment periods are 60 calendar days (interim payments) and 120 calendar days (final payments).

Claims under contracts can be made as statutory 'Payment Claims' and if these are ignored or disputed they can be taken to adjudication for a binding decision.

Diagram 1: Longest permissible Payment Response and payment periods under SOPL



Adjudication of disputes

For SOPL to be successful it is very important that each party to a contract has the right to force resolution of disputes quickly and cost effectively. Adjudication is a process where a third party adjudicator makes a binding decision without the delays and formality of court or arbitration.

Adjudication changes the dynamic between claiming parties and paying parties. Payers know that action can be rapidly taken against them if they do not act reasonably.

The proposed adjudication process has the following features:

- Both parties will be entitled to refer a dispute to adjudication but limited to disputes about Payment Claims and extension of time.
- Most adjudicators will be experienced construction professionals such as surveyors, engineers and architects or construction lawyers. Parties will be able to agree an adjudicator after a dispute arises or obtain a rapid nomination from the Hong Kong International Arbitration Centre.
- A typical adjudication should take up to 60 working days. This includes 5 working days for appointment of the adjudicator and 55 working days for the procedure itself.
- Once the adjudicator is appointed, the claiming party serves submissions explaining their claim and the contractual and legal arguments relied on together with supporting evidence. This could include documents, emails, drawings, photographs, witness statements and expert reports depending on the nature of the case. The Responding party will normally have 20 working days to respond with their submissions and evidence.
- The adjudicator controls the overall procedure. They may allow further submissions. They may raise questions. They may need to see the building site. Possibly they may convene a meeting at which the parties can make oral presentations, provide further explanations and answer questions. Most adjudications will be done on a “documents only” basis.
- The adjudicator must reach their decision within 55 working days. Any extension must be agreed by both parties. Shorter timescales will be possible for simpler cases.
- Each party will bear its own costs in connection with the adjudication. The adjudicator can decide who will bear the adjudicator’s fees and expenses or can apportion them between the parties.
- Adjudicator’s decisions are enforceable rapidly through the courts. An error of law or fact by the adjudicator is not a ground for resisting enforcement. The only basis for the court refusing enforcement would be if the paying party could show convincingly that the procedure adopted was materially unfair or the adjudicator had exceeded their remit.
- Each party can take the adjudicated dispute to court or arbitration for final determination using the normal procedures and timescales. The adjudicator’s decision stands in the interim and any amounts found due would have to be paid. Ultimately the court or an arbitrator might decide that more money had to be paid or money had to be repaid.

SOPL provides a statutory right to adjudicate payment disputes and extension of time disputes. The procedure is far more rapid and cost effective than court or arbitration. Many parties who cannot afford the costs of court or arbitration will be able to adjudicate.

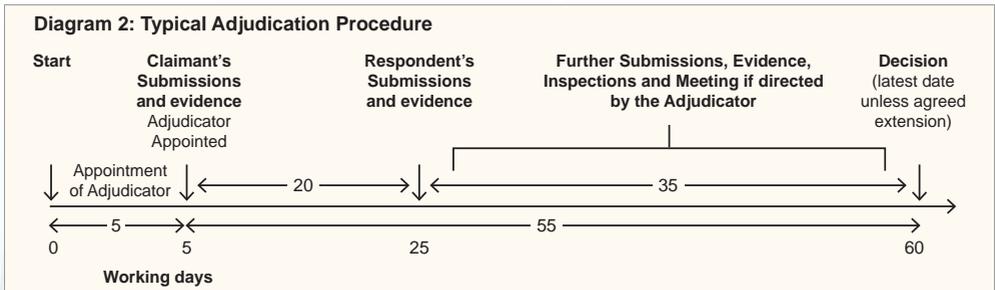
Adjudications should take no longer than 60 working days unless both parties agree to longer. The procedure is flexible and far less formal than court or arbitration.

Adjudication experience overseas is that parties often accept adjudicators' decisions as finally determining disputes and they are not taken further. This reduces time and money spent by the industry on legal proceedings although there are sometimes complaints that claimants can “ambush” paying parties. This is done by referring complex, high value claims to adjudication without warning in the hope that the paying party will find it difficult to respond effectively in the short adjudication timescales. The following features of the proposed SOPL address this concern:

SOPL changes behaviors and improves administration of contracts.

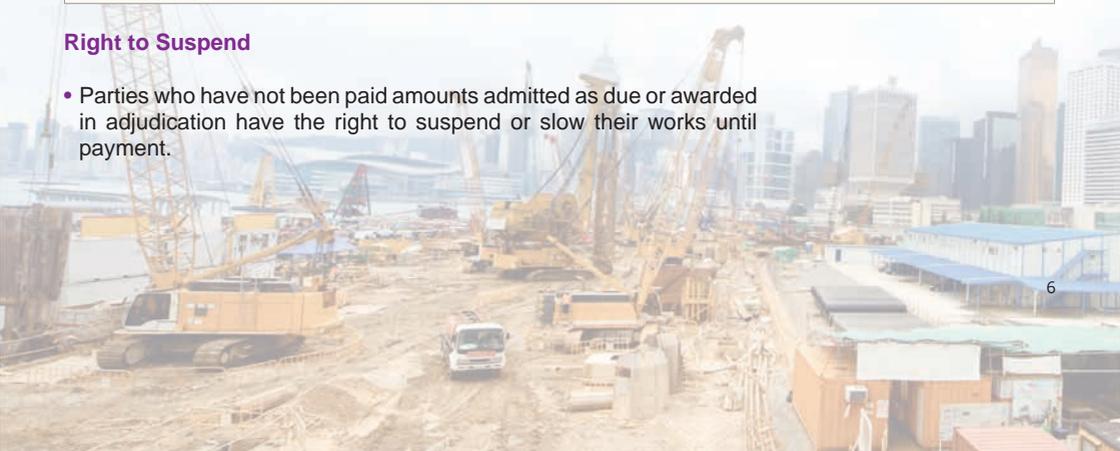
- Adjudications must be commenced within 28 calendar days of the dispute arising. This requirement means that paying parties will know when adjudications might be commenced.
- The adjudication timescale of 60 working days is a long period compared to jurisdictions where ambush complaints are most prevalent. For example, in the UK adjudications may have to be concluded within only 28 calendar days.
- Adjudicators will be entitled to disregard any submissions or evidence submitted by a claimant which were not provided to the responding party before the adjudication (for example, as part of a Payment Claim) and which cannot be dealt with fairly in the adjudication. Where an adjudicator considers a dispute is too large and complex to be decided fairly they can resign.

Hong Kong's proposed adjudication process is subject to specific safeguards against “ambush”.



Right to Suspend

- Parties who have not been paid amounts admitted as due or awarded in adjudication have the right to suspend or slow their works until payment.



Schedule 1

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

Consultation Closing Date

31 August 2015

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The Consultation Document is available at the Public Enquiries Centres of the Home Affairs Department and the Development Bureau website (www.devb.gov.hk/sop).

