

For discussion on
11 September 2018

Legislative Council
Panel on Development and Panel on Home Affairs
Joint Subcommittee to Monitor the Implementation of the
West Kowloon Cultural District Project

M+ Main Works Contract

PURPOSE

This paper gives a full account of the process and considerations leading to the decision by the West Kowloon Cultural District Authority (WKCD or the Authority) to terminate the employment of Hsin Chong Construction Company Limited (HCC) under the M+ main works contract on 17 August 2018.

BACKGROUND

2. M+ is a museum dedicated to collecting, exhibiting, and interpreting visual art, design and architecture, moving image, and Hong Kong visual culture of the 20th and 21st centuries. Located within Hong Kong's West Kowloon Cultural District (WKCD), the M+ building is one of the largest museums of modern and contemporary visual culture in the world, with a bold ambition to establish M+ as one of the world's leading cultural institutions. The aim is to create a new kind of museum that reflects Hong Kong's unique time and place, a museum that builds on Hong Kong's historic balance of the local and the international to define a distinctive and innovative voice for Asia's 21st century.

3. M+ is designed by the Swiss architectural firm Herzog & de Meuron, in joint venture with Hong Kong-based TFP Farrells and Ove Arup & Partners Hong Kong.

4. The M+ building and the Conservation and Storage Facility together will provide approximately 65 000 square metres in gross floor area. Comprising a horizontal block at the lower levels

with a vertical tower above, the M+ building will create an iconic presence for M+, and Hong Kong, on the WKCD site overlooking Victoria Harbour. The horizontal part of the building will house exhibition spaces and galleries with a learning centre, a moving image centre, museum shops and cafes, creator's studios and back-of-house functions. The vertical tower will house a research centre, a curatorial centre and retail/dining/entertainment facilities on the top floors.

M+ MAIN WORKS CONTRACT

5. The tender for the main works contract for M+ was issued in March 2015. The contract, which included work on the M+ building, the Conservation and Storage Facility, a retail, dining and entertainment/other arts and cultural facilities building (P39B); an interfacing car park; and some related public infrastructure works, was awarded to HCC on 26 September 2015. The total contract value was HK\$5.944 billion. Consistent with industry practice and as required under the M+ main works contract, HCC procured an on-demand Performance Bond¹, which was provided by AIG Insurance Hong Kong Limited (AIG).

6. WKCD closely monitors the performance of all works contractors on building projects within WKCD, including the M+ project, to ensure that work is carried out in accordance with the agreed programme, the agreed target dates, the required quality and the approved budget.

7. On 28 September 2016, an Anonymous Analytics article about HCC's parent company, Hsin Chong Group Holdings Limited (HCG), was published online. The article claimed that HCG was facing financial difficulties. WKCD immediately followed up with HCC to ascertain what exactly the situation was. In view of the serious nature of the allegation contained in the article and the inextricable links between the delivery of the M+ project and the financial solvency of HCG/HCC, especially its ability or otherwise to pay its subcontractors and in turn the workers, external legal and insolvency advisers (EA) were appointed by WKCD in October

¹ Performance bond guarantees the faithful performance of the contract by the contractor in accordance with the terms and conditions set out in the contract. The project owner is the obligee of a performance bond.

2016 to assist in the analysis of HCC's financial position. The EA presented key findings of their research to Management in October 2016. Notably, they recommended the Authority should prepare a positive risk mitigation plan in case the situation deteriorated.

8. Management first briefed the WKCDA Board on the situation at the 55th Board Meeting on 8 November 2016. The Board have been kept fully informed of the situation throughout and their approval sought for actions taken as necessary. A chronology of events is set out in **Annex 1**.

9. During the 55th Board Meeting, Members noted the Management's recommendation that: -

- i) WKCDA should take proactive steps to secure the M+ construction project;
- ii) the Executive Committee (ExCom) should be delegated authority to guide Management on steps to be taken on behalf of the Board; and
- iii) in the event of a serious deterioration in HCC's financial situation, Management should move very quickly and as necessary to proceed by way of a restricted or single tender to secure the necessary management contractor resources to ensure that the construction can be taken through to completion.

10. Members of the Board unanimously approved the following resolutions: -

- i) authorise Management to incorporate a specific purpose vehicle subsidiary (Blue Poles Limited (BPL)) for the purpose of protecting the interests of WKCDA with respect to the M+ project.
- ii) until further notice, the WKCDA Board delegates to ExCom, with power to sub-delegate to the Chief Executive Officer (CEO), for the purpose of overseeing the management and control of the completion of the M+ main works to:
 - a) cause BPL to enter into contracts with management contractors, building and

- construction subcontractors;
- b) create and register a floating charge over all the assets and undertakings of BPL to secure WKCDA's interests in BPL; and
- c) select, and cause BPL to enter into contracts with consultants, contractors and service providers as may be needed to ensure the timely completion of the M+ project.

11. At the 58th Board Meeting on 14 February 2017, Management advised the Board that at the request of HCC and after consulting the EA, due to HCC's deteriorating financial situation, in particular its cash flow, WKCDA made direct payments to key subcontractors to ensure that the works continued and that employees were paid on time. The monies paid to subcontractors were deducted from the contract sum payable to HCC by WKCDA. Members also noted that, as a precautionary measure, Management had been considering what steps could be taken under the terms of the contract if the situation further deteriorated.

12. As agreed with HCC, the direct payment measure was always intended to be temporary and subject to review from time to time. All direct payments were to be made in accordance with an agreed schedule of payments under the contract and against certificates of work carried out by the subcontractors concerned. Each payment was determined based on a detailed submission prepared by HCC, vetted and approved by the third-party Contract Administrator (CA). In compliance with the terms of the contract and with the agreement of HCC, payments were made to subcontractors directly to ensure that they and their employees received payment for work done. The payment arrangements were explained in the LegCo Finance Committee (FC) meetings in December 2017 and again in January 2018 in response to Members' concerns about late payments to workers on the project. Please refer to the transcripts of the related reply at the FC meetings at **Annex 2**.

13. At the 59th Board Meeting on 28 March 2017, Management reported that the direct payments to the subcontractors were proceeding smoothly, and that as a result, the progress of works had improved on the M+ building site.

Management would continue to monitor the situation closely.

14. At the 22nd ExCom Meeting on 30 March 2017, ExCom, as delegated by the Board at the 55th Board Meeting, agreed to exercise its power to sub-delegate to the CEO to oversee the management and control of the completion of the M+ main works.

15. On 3 April 2017, trading in the ordinary shares and debt securities of HCG was suspended. On 19 April 2017, HCG's audited consolidated annual results published for the year ended 31 December 2016 telegraphed a significant deterioration in HCG's business, liquidity and financial position but made no mention of any tangible solutions for its financial and operational problems. At the 61st WKCDA Board Meeting on 9 May 2017, Members approved that in the event that a default by HCC happened before the Board could meet to discuss it, Management had the authority to:

- i) trigger the default mechanism under the M+ main works contract and terminate the M+ main works contract;
- ii) call on the on-demand Performance Bond; and
- iii) secure the site.

16. Over the proceeding months, WKCDA continued to frequently interact with HCC's top management in order to keep the Board fully informed of the financial situation of HCC and HCG. WKCDA also continued to pressure HCC to improve the progress of the works on site by hiring more workers and retaining the existing ones. Improved progress of the M+ main works was made. The construction and load transfer of the mega trusses was completed in September 2017, achieving a key milestone in the development of the project.

17. On 18 May 2018, HCG made an announcement that their US\$300 million 8.75% senior notes due 2018 (2018 Notes) fell due for redemption on that date but HCG had not made payments of the sums due in respect of the 2018 Notes on the maturity date, which (1) constituted a cross-default on its US\$150 million 8.5% senior notes due 2019 (2019 Notes) and (2) had resulted in cross-defaults under other loan agreements to which HCG and/or its subsidiaries were parties. HCC was a guarantor of the 2019 Notes, that is, the 2019 Notes have become a debt of HCC and hence

reinforced the insolvency of HCC. On or about 21 May 2018, AIG became aware of HCG's default under the 2018 Notes and thus demanded cash collateral of HK\$297 million from HCC and HCG.

18. At the 73rd Board Meeting held on 28 June 2018, the Board were briefed in detail about the situation. CEO informed the Board that in light of advice from the EA, WKCDA should take action to protect its position and the Board decided that WKCDA would discontinue the temporary arrangement of direct payments to subcontractors from July 2018 onwards. By doing so, WKCDA gave a very clear signal to HCG that it expected HCC to assume its full responsibilities under the contract.

19. On 16 July 2018, a local newspaper published a headline story saying that WKCDA had been making direct payments to the subcontractors of the M+ construction project since February 2017 because of HCC's and HCG's financial difficulties. That same day WKCDA issued a press statement to confirm this longstanding arrangement. It is important to note that the arrangement was strongly supported by the industry. Please refer to the supportive letters sent by subcontractors regarding WKCDA's arrangement of direct payments at **Annex 3**.

20. A further article was published on 17 July 2018 in relation to direct payment to HCC's subcontractors. That same day, WKCDA hosted a media stand-up to provide further clarification, and announced the Board's prior decision to stop the direct payments to HCC's subcontractors.

21. It is WKCDA's normal and longstanding practice to provide the public with an update on progress on the various projects through the CEO's report at the open session of each Board meeting. These reports have included specifically information on the progress of the M+ construction project. WKCDA's concerns over the progress on this project and the delays encountered were voiced publicly at the open sessions of the Board Meetings held on 22 February 2018, 28 June 2018 and most recently 16 August 2018.

22. On 16 August 2018 at the 74th Board Meeting, the Board was again briefed on the situation following the cessation of direct payments to subcontractors and return to the contractual 60

day payment cycle. The Board noted in particular that work on site had slowed dramatically, with some subcontractors simply walking off the site in response to HCC's failure to pay them in July 2018 for work carried out in June 2018. Bearing this in mind, and in light of their default in their repayment of 2018 Notes, HCC's inability to pay its subcontractors and the continued failures to advance the project in line with the agreed timetable, Members unanimously agreed to terminate HCC's employment under the M+ main works contract with effect from 17 August 2018. The Board also decided to call the Performance Bond provided by AIG following the action to terminate HCC's employment. This action was fully in accordance with the terms of the contract.

CURRENT ACTIONS

23. Following the termination of HCC's employment under the contract, WKCDA took action to secure the site. WKCDA is carrying out a restricted tender to secure a management contractor to take over the M+ construction project and to see it through to completion. It is anticipated that this would take about six to eight weeks to arrange. In the meantime, the site has been closed down and only essential maintenance and safety management would be allowed to be carried out. Access to the site is restricted.

24. WKCDA intends to use best endeavours to secure all the current subcontracts for the M+ construction project by way of novation. It has initiated discussions with subcontractors and has already started the novation process with a number of novations already agreed.

CONSTRUCTION PROGRESS OF THE M+ BUILDING

25. Overall 60% of the construction of the M+ building has been completed. The remaining work is technically straightforward and less demanding. It is clear that the M+ construction project will face a delay while a new management contractor is put in place. However, it is expected thereafter that some of the delay may be caught up. Subject to WKCDA being able quickly to procure a new management contractor and novate all the relevant subcontractors, the intention is to maintain the programme that has been previously announced for completion of the M+ construction project

in time for the museum to open in 2020.

26. Since the M+ building is located immediately above the existing tunnels for the MTR Airport Express and Tung Chung line, any movement induced from the M+ foundations and building works was a major concern to both MTR Corporation Limited (MTRCL) and WKCDA. As such, the construction has stringent technical compliance requirements, including the installation of five mega trusses to distribute the weight of the M+ building safely over the tunnels. The construction and load transfer of the mega trusses was completed in September 2017. Many engineering and technical challenges have been overcome during the M+ construction project. It is worth saying that the close supervision by WKCDA, resident site staff and the architectural design team have ensured that the quality of work has been maintained throughout. There are over 70 resident site staff and representatives of the architectural and engineering design team stationed on site for this purpose.

27. There will be additional costs arising from the need to close down the site and to arrange a new management contractor. It is the aim of Management to offset some of these costs by more efficient management and improved progress. WKCDA has examined the potential final cost of the project using a new management contract and novating the existing subcontractors, but due to ongoing commercial reasons with all third parties, it is not appropriate to discuss the amounts at this time.

ADVICE SOUGHT

28. Members are invited to note the content of this paper.

West Kowloon Cultural District Authority
September 2018

**Chronology of Events
(November 2016 to 31 August 2018)**

1. On 26 September 2015, West Kowloon Cultural District Authority (“WKCD”) entered into a contract for main works (“Contract”) with Hsin Chong Construction Company Limited (“HCC”) in respect of the development of the M+ Museum (“Project”) within West Kowloon Cultural District for a contract sum of approximately HK\$5.94 billion. HCC is a wholly owned subsidiary of Hsin Chong Group Holdings Limited (“HCG”). HCG is listed on The Stock Exchange of Hong Kong Limited (“Exchange”).
2. Construction of the Project commenced on 26 September 2015 with practical completion scheduled to be achieved in 40 months, which is around January 2019.
3. WKCD is the beneficiary of a HK\$297,198,000 performance bond issued by AIG Insurance Hong Kong Limited (“AIG”) and arranged by HCC (“Bond”).
4. In late 2016, WKCD grew concerned that despite payments made by WKCD to HCC, HCC had failed to pay its subcontractors and suppliers in a timely manner. This adversely impacted the progress of the Project.
5. From November 2016, HCC has been unable to pay its subcontractors from its own resources. HCC approached WKCD with an objective of rescheduling some of the payments and provided WKCD with a list of subcontractors which they owed money. The amounts owed were substantial.
6. A system was implemented by WKCD from February 2017 to effect direct payments to the subcontractors of HCC. In order to improve the cash flow of HCC and its subcontractors, the payment period was also reduced from a 60-day cycle to a 30-day cycle which commenced in January 2017.
7. On 30 March 2017, HCG issued an announcement in respect of certain disclosable transactions with Mr Zhou Wei, Executive Director and Chief Strategic Officer, and his associated companies which were not disclosed at the time of the transactions as required by the Listing Rules. HCG made 2 unsecured loans totalling RMB376.5 million to Mr Zhou and his associated companies between 2 August 2016 and 27 December 2016, repayable on or before November 2018 and August 2024 respectively. The announcement of the transactions had all the hallmarks of previously undisclosed related party transactions which have been identified during the audit process.
8. On 3 April 2017, the shares of HCG were suspended from trading.

9. On 19 April 2017, HCG published its audited consolidated annual results for the year ended 31 December 2016 (“2016 Financial Results”). The 2016 Financial Results telegraphed a significant deterioration in the HCG’s business, liquidity and financial position and make no mention of any tangible solutions for its financial and operational problems. Key observations from the 2016 Financial Results included the following:
- 9.1 a net loss attributable to the equity holders of HCG totalling HK\$2,734 million and a net operating cash outflow of HK\$1,334 million;
 - 9.2 negative earnings before income, taxation, depreciation and amortisation (“EBITDA”) of HK\$4,040 million, which might constitute an event of default under the indenture of HCC’s US\$300 million 8.75% Senior Notes due on 18 May 2018 (“2018 Notes”), which required EBITDA to be at least 1.5 times its fixed charges;
 - 9.3 total borrowings increased by 391% from HK\$2,356 million to HK\$11,580 million as at 31 December 2016, of which HK\$6,551 million or 57% were classified as current liabilities;
 - 9.4 on 22 March 2017, HCG received notice from a financier demanding immediate repayment of outstanding borrowings totalling HK\$796 million which was subsequently settled by HCG;
 - 9.5 HCG’s auditors, PricewaterhouseCoopers (“PwC”), expressed “*multiple uncertainties relating to the going concern*” opinion in its disclaimer to the 2016 Financial Statements. The uncertainties exist for the following reasons (among other factors):
 - 9.5.1 net operating cash outflow of HK\$1,334 million;
 - 9.5.2 HK\$6,551 million or 57% of total borrowings of HCG’s borrowings would be payable within 1 year; and
 - 9.5.3 the threat of events of default under various borrowing agreements, which would cause approximately HK\$6,294 million of borrowings to become immediately repayable;
 - 9.6 the auditors also expressed concerns in respect of payments made pursuant to certain transactions entered into by HCG which were not adequately explained by management, including:
 - 9.6.1 transactions and balances relating to Mr Zhou and his related entities (RMB376.5 million), following which the auditors requested an independent investigation into the approval, authenticity and

commercial substance of the transactions;

9.6.2 payments of RMB683 million made to a construction company, for which adequate documentary evidence to support the nature and commercial substance of the transactions was not provided by management; and

9.6.3 payments of RMB120 million made to certain financial consultancy companies.

10. The auditors also advised that HCG's directors were undertaking a number of measures to improve HCG's liquidity and financial position, and to regularise certain delayed repayments to financial institutions, which were subject to multiple uncertainties. The auditors did not express an opinion on the consolidated financial statements of the HCG due to the material uncertainties relating to going concern and the insufficient audit evidence obtained. The auditors retired as auditor of HCG at the annual general meeting of HCG.
11. On 28 April 2017, HCG issued an announcement that it had conditionally agreed to sell its Hong Kong corporate office for HK\$760 million with sale proceeds to be used for working capital purposes. HCG received HK\$50 million initial deposit and was to receive a further deposit of HK\$100 million on the signing of agreement and the remaining 80% (HK\$610 million) upon the completion of the sale on or before 31 July 2017.
12. Public searches conducted in mid-May 2017 indicate that the following securities have been registered against HCG and HCC:
 - 12.1. on 7 April 1992, HCG created a first floating charge over all its assets and properties, both present and future, in favour of HSBC ("HSBC Charge") for any amount due by HCC and Hsin Chong Construction (Asia) Limited pursuant to a Debenture dated 7 April 1992. The current balance of the amounts owed to HSBC is not publicly available, but HCG's total secured bank debts as set out in HCG's 2017 Annual Report approximated HK\$832.4 million;
 - 12.2. on 21 September 2016, HCC assigned its receivables and created a floating charge over future receivables under the Contract to China Development Bank Corporation, Hong Kong Branch ("CDB") as security for repayment to CDB including a term loan of HK\$300 million; and
 - 12.3. on 18 November 2016, HCG created a first fixed charge in respect of its entire 150,000 shares in Hsin Chong Construction (BVI) Limited ("HC BVI") ("Secured Shares") in favour of 广田控股集团有限公司 (Grandland Holdings

Group Co Ltd) (“Grandland”) for repayment of a loan facility of US\$100 million provided by Grandland pursuant to a Share Charge Agreement dated 18 November 2016 (“Grandland Charge”). Grandland is a construction conglomerate incorporated in Shenzhen, PRC with its shares trading on Shenzhen Stock Exchange (stock code: 002482).

13. On 22 May 2017, HCG missed the payment of HK\$102.4 million coupon on its 2018 Notes and the missed coupon was subsequently paid on 14 June 2017.
14. On 14 June 2017, the Grandland Charge was released by Grandland “*upon the request of the Chargor [HCG]*” but there is not any indication that the US\$100 million loan facility has been repaid by HCG.
15. On 11 July 2017, HCG issued an announcement that on 28 April 2017, it had entered into a Sales and Purchase Agreement for the sales of its principle Hong Kong office building in Kwun Tong (“Kwun Tong Office”) in the amount of HK\$760 million.
16. On 14 August 2017, HCG:
 - 16.1. redeemed all outstanding US\$100 million 6% convertible bonds due 2017 in full;
 - 16.2. appointed BDO Limited as the independent auditor following the retirement of PwC with effect from 14 August 2017; and
 - 16.3. completed the sale of the Kwun Tong Office for HK\$760 million.
17. On 25 August 2017, HCG announced that it is expected to record a loss for the six months ended 30 June 2017, compared to a profit for the six months ended 30 June 2016.
18. On 29 September 2017, HCG released its 2017 interim report with the following financial highlights:
 - 18.1. revenue of HCG decreased significantly from HK\$9.82 billion for the year ended 31 December 2016 to HK\$3.44 billion for the 6 months ended 30 June 2017;
 - 18.2. the building construction, civil engineering and electrical and mechanical segments (“Construction Segment”) of HCG recorded a profit of HK\$8.6 million only for the first 6 months in 2017;
 - 18.3. HCG incurred losses of HK\$2.71 billion for the year ended 31 December 2016 and HK\$1.07 billion for the 6 months ended 30 June 2017;

- 18.4. the property segment of HCG incurred losses of HK\$2.92 billion for the year ended 2016 and HK\$1.22 billion for the 6 months ended 30 June 2017;
- 18.5. HCG received new orders of HK\$136 million during the first half of 2017, which was immaterial (2.6%) relative to new orders of HK\$5.189 billion for the year ended 31 December 2016; and
- 18.6. outstanding workload of HCG totalled HK\$9 billion, of which HK\$4 billion related to the Project (44%).
19. On 29 September 2017, HCG announced that Deloitte was engaged on 25 July 2017 to conduct an independent forensic review of the audit issues raised by the former auditor in the 2016 independent auditor's report.
20. On 14 November 2017, HCG reached a settlement at HK\$40 million in respect of the HK\$209 million claim with Sugisaki Kiso.
21. On 18 November 2017, HCG (again) missed the payment of HK\$102.4 million coupon on the 2018 Notes and the missed coupon was subsequently paid on 19 December 2017.
22. On 19 November 2017, HCG's HK\$34 million zero coupon convertible bonds were due for redemption. However, the publicly available information does not indicate that this HK\$34 million has been redeemed by HCG.
23. On 10 January 2018, HCG announced that Deloitte issued a draft report on 29 December 2017 as part of their forensic review. Set out below is a summary of the Deloitte's draft report:
 - 23.1. Deloitte concluded that the management was responsible for the commercial consideration of the transactions concerning identified issues and should make business decisions based on its understanding of the market, operating costs and profitability, which might involve long-term development of HCG.
 - 23.2. Deloitte did not find any clear evidence that some individuals misappropriated funds or undertook other commercial frauds by virtue of the transactions involved in the identified issues. In this light, Deloitte claimed that they were not able to prove that such transactions caused apparent and significant economic or financial losses to the Group.
 - 23.3. Deloitte found that there were weaknesses in group management and certain internal control systems inside the Group. For instance, the management of HCG had no knowledge of the transactions with its subsidiaries and related parties and had no sound and effective management mechanism. Meanwhile,

there was clearly a lack of understanding among some of the management members in recognising notification transactions and connected transactions under the Listing Rules.

- 23.4. Deloitte found that HCG did not clearly define material transactions and clarify the reporting requirements for subsidiaries on major issues. On the one hand, senior management explained that due to various negative factors, the Group failed to obtain loans through general financial institutions and thus needed to raise money at a very high cost by entrusted loans. At the same time, HCG's subsidiaries provided large amount of loans to associated entities of Mr Zhou without the knowledge of the Board within a relatively close period of time, highlighting the potential conflicts in the management.
24. On 19 January 2018, HCG issued a response in respect of the Deloitte's Final Investigation Report. The Independent Investigation Committee accepted the factual findings made by Deloitte.
25. On 22 January 2018, HCG missed the payment of the US\$6.375 million coupon on its US\$150 million 8.5% Senior Notes due 2019. HCG did not make any further announcement about any payment of this missed coupon.
26. On 2 May 2018, HCG announced, inter alia, the following:
 - 26.1. HCG was in discussions with Poly Property Group Co., Limited ("Poly Group"), a Hong Kong listed company, which expressed interest in investing in HCG. Poly Group commenced due diligence but no legally binding agreement was entered into with HCG; and
 - 26.2. on 30 April 2018, HCG signed a framework agreement ("Foshan Framework Agreement") with Kaisa Group Holdings Limited ("Kaisa"), a Hong Kong listed company, in relation to a strategic business cooperation in relation to real estate projects in PRC. The Guangdong Foshan Project was the first project under this cooperation.
27. HCG has not provided any further update in respect of Poly Group as at the date of this chronology.
28. HCG also announced that it had engaged Moelis & Company as financial adviser and Kirkland & Ellis as legal adviser to assist HCG in evaluating its options and to work towards a consensual solution for its upcoming debt maturities.
29. On 17 May 2018, HCG announced its 2017 Annual Report. As at 31 December 2017:
 - 29.1. HCG's revenues decreased significantly from HK\$9.82 billion in 2016 to HK\$6.30 billion in 2017.

- 29.2. HCG suffered a net loss of HK\$571 million and negative operating cashflow of HK\$2.64 billion for the year ended 31 December 2017.
 - 29.3. HCG's net current assets were approximately HK\$5.35 billion.
 - 29.4. HCG's current liabilities were HK\$16.3 billion and total non-current liabilities were HK\$8.2 billion.
 - 29.5. HCG's net assets were recorded at HK\$11.70 billion but had little or no material immediate net realisable value.
 - 29.6. HCG's total deposits, cash and cash equivalents as at 31 December 2017 totalled HK\$784 million and HCG did not have sufficient cash or equivalent to meet such financial payment obligations.
 - 29.7. HCG had negative operating cashflow of HK\$1.33 billion for the year ended 31 December 2016 and HK\$2.64 billion for the year ended 31 December 2017.
30. HCG's 2017 Annual Report describes that:
- 30.1. The Construction Segment was primarily engaged and conducted by HCC, HCG Aster Building Services Limited and HCG Construction (Asia) Limited. Construction Segment is the core operating segment of HCG and contributed more than 99.0% of the revenue in both 2016 and 2017.
 - 30.2. There was a significant decrease in the profitability of the Construction Segment in 2016 and 2017, from profit before taxation of HK\$305.1 million in 2016 to loss before taxation of HK\$7.72 million in 2017. Such a decrease was primarily due to the following:
 - 30.2.1. the shrinking of the Construction Segment operations, with revenue decreasing from HK\$9.31 billion in 2016 to HK\$6.06 billion in 2017; and
 - 30.2.2. a decrease in gross margin from 4.7% in 2016 to 2.3% in 2017.
 - 30.3. During the 2017 financial year, HCG claimed to have received total new orders of HK\$619 million including the following major contracts:
 - 30.3.1. P4002 direct contract for PPC Pile Works for Galaxy Resort & Casino Phase 4, Lot 4 New Integrated Resort Development at Cotai City, Macau;

- 30.3.2. Contract No. CV/2016/10 Site Formation and Associated Infrastructural Works for Development of Columbarium at Sandy Ridge Cemetery;
- 30.3.3. a sub-contract for air-conditioning installation for construction of Sports Center, Community Hall and Football Pitches in Area 1, Tai Po; and
- 30.3.4. a sub-contract for air-conditioning and mechanical ventilation installation for construction of Public Rental Housing Redevelopment at Pak Tin Estate Phases 7 and 8.

This has decreased significantly and is nearly immaterial (10.7%) relative to new orders of HK\$5.782 billion in 2016. The available information does not explain how HCC would fund the working capital and banking facilities (such as performance and other bonds) likely necessary to fulfill these new orders.

- 30.4. HCG had 20 projects in progress as at 31 December 2017, of which 17 projects in progress will be completed by July 2019.
- 30.5. HCG's 2017 Interim and Annual Reports and announcements published by HCG on the Exchange indicate that as of November 2017, HCG was required to make the following payments totalling at least HK\$4.738 billion between November 2017 and January 2019:

Date	Description	HK\$ in millions
18 November 2017	Semi-annual coupon payment of the US\$300 million 8.75% Senior Notes due 2018	102.4
19 November 2017	Redemption of the HK\$34 million zero coupon convertible bonds	34.0
By 31 December 2017 (Estimate)	Settlement payment to Sugisaki Kiso	40.0
22 January 2018	Semi-annual coupon payment of the US\$150 million 8.50% Senior Notes due 2019	49.7
18 May 2018	Repayment of principal and semi-annual coupon payment of the US\$300 million 8.75% Senior Notes due 2018	2,442.4
22 July 2018	Semi-annual coupon payment of the US\$150 million 8.50% Senior Notes due 2019	49.7
30 September 2018	Repayment of facility from a related company of a substantial shareholder	800.0

Date	Description	HK\$ in millions
22 January 2019	Repayment of principal and semi-annual coupon payment of the US\$150 million 8.50% Senior Notes due 2019	1,219.7
Total		4,737.9

31. On 18 May 2018, HCG made an announcement that the 2018 Notes fell due for redemption on 18 May 2018 but HCG had not made payments of the sums due in respect of the 2018 Notes on the maturity date, which (1) constitutes a cross-default on its US\$150 million 8.50% Senior Notes due 2019 (“2019 Notes”), and (2) has resulted in cross-defaults under other loan agreements to which HCG and/or its subsidiaries are parties.
32. HCC is a guarantor of the 2019 Notes. That is, the 2019 Notes (in the amount of US\$150 million) have become a debt of HCC and hence reinforced the insolvency of HCC.
33. As described in paragraph 59 below, HCG has not reached any resolution, extension or standstill agreement with its 2018 and 2019 Notes holders and other creditors.
34. On or about 21 May 2018, AIG became aware of HCG’s default of the 2018 Notes and thus demanded cash collateral of HK\$297 million from HCC and HCG.
35. On 1 June 2018, Synergis Holdings Limited (“Synergis”), a Hong Kong listed company (stock code: 2340) which ceased to be a subsidiary of HCG on 21 November 2016, announced that it had signed a second settlement agreement with HCG for the repayment of HK\$75.8 million from HCG.
36. Synergis has previously entered into the Supplemental Agreement with HCG on 17 August 2017 in addition to the Settlement Agreement dated 27 March 2017 for the recovery of the remaining balance of receivables of HK\$66.7 million as of 31 December 2016 by instalments, pursuant to which the deadline of the payment period had been deferred from 31 July 2017 to 1 June 2018. However, other than the repayment of HK\$3.3 million on 30 October 2017 under the Supplemental Agreement, Synergis has not received any further repayment from HCG.
37. On 17 July 2018, WKCDA notified HCC its decision made on 28 June 2018 that WKCDA would terminate the making of direct payments to HCC’s subcontractors and advise that all future payments for the Project would be made strictly in accordance with the Contract with effect from July 2018, that is, the payment period would return from a 30-day cycle to a 60-day cycle.

38. As at 17 August 2018, HK\$1.5 billion was paid directly by WKCDA to HCC's subcontractors.
39. On 27 July 2018, HCG announced that Industrial and Commercial Bank of China (Asia) Limited ("ICBC") had appointed receivers to all shares in a subsidiary of HCG which primarily holds a commercial property for rent in Guangzhou.
40. The Receivers' appointment by ICBC is another strong indication that, despite the attempts being made by HCG to restructure its debts, banks and financial creditors remain concerned with HCG's default of the 2018 Notes and its insolvency.
41. On 31 July 2018, HCG announced that the Exchange may cancel its listing status if it fails to fulfil all the resumption conditions imposed by the Exchange by 31 July 2019, including due diligence by the potential investor, formation of a Noteholders Committee and settlement by Zhou Wei (former executive director) of all outstanding balances due to HCG.
42. On 6 August 2018, HCG made the following announcement:
 - 42.1. The Foshan Framework Agreement gave Kaisa a First Right of Refusal to sign specific agreements for each and every one of the real estate projects until 31 December 2018. Kaisa had given up its right to sign any further specific agreements; and
 - 42.2. HCG negotiated a cooperation framework agreement with another PRC real estate company ("Real Estate Partner") in relation to the Guangdong Foshan Project which was said to be conducting due diligence. No agreement has been signed with this new Real Estate Partner.
43. Despite HCG's attempts over 3 months from May to August 2018, HCG has not been able to secure an investor for the Guangdong Foshan Project.
44. Between mid-May 2018 and 17 August 2018, WKCDA sought and obtained opinions from Senior Counsel and an insolvency expert confirming that HCC is insolvent.
45. The Contractor Administrator has assessed that the Project is suffering from severe delays of approximately 48 to 50 weeks. The delays are attributable to a lack of financial and other resources available to HCC.
46. On 17 August 2018, WKCDA terminated the employment of HCC under the Contract.
47. On 17 August 2018, WKCDA called and demanded payment of the Bond in respect of the damages, losses, charges, costs or expenses sustained by WKCDA from AIG.

48. On 21 August 2018, AIG repeated its demand for payment of the Bond's amount of HK\$297 million from HCC and HCG.
49. On 21 August 2018, HCG made a voluntary announcement in which HCG disagrees with the alleged reason of termination of the Project in relation to insolvency.
50. On 22 August 2018, the Mandatory Provident Fund Schemes Authority ("MPFA") commenced legal action against HCC in HCA 1969 / 2018 for its failure to make MPF contributions for its staff totalling HK\$4.34 million with MPFA from March to June 2018.
51. On 24 August 2018, another news article published by a local newspaper described that HCC was also involved in a labour dispute in relation to the Shatin-Central Link project. The new article cited an unnamed employee of HCC stating that HCC has failed to pay the bonus for the year 2016 in full to the workers. The workers are seeking assistance from the Labour Department demanding payment from HCC in respect of the outstanding bonus.
52. HCC replied to the Labour Department that HCC was unable to pay the outstanding bonus to the workers and that HCC would not participate in any mediation with the workers. The workers are now planning to file a claim against HCC with the Labour Tribunal for payment of the outstanding bonus.
53. On 27 August 2018, a winding-up petition was filed by Kenworth Engineering Limited ("Kenworth") against HCC for its failure to settle a sum of HK\$8.28 million for construction costs payable in HCCW 239 / 2018. The hearing of the petition is scheduled for 31 October 2018.
54. On 29 August 2018, a PRC cement company, Shenzhen Yong Yi Tong Cement Co., Ltd. (深圳永易通水泥制品有限公司), commenced legal action against HCC for outstanding debts of HK\$4.43 million in HCA 2037 / 2018.
55. On 31 August 2018, HCG announced its 2018 interim report with the following financial information:
 - 55.1. revenue of HCG decreased from HK\$6.30 billion for the year ended 2017 to HK\$3.44 billion for the 6 months ended 30 June 2018;
 - 55.2. the Construction Segment recorded a profit of only HK\$14.1 million for the 6 months ended 30 June 2018;
 - 55.3. HCG suffered a net loss of HK\$642 million for the 6 months ended 30 June

2018, which already exceeded the net loss of HK\$571 million for the year ended 31 December 2017;

- 55.4. HCG's net current assets decreased significantly from HK\$5.35 billion as at 31 December 2017 to HK\$902.4 million as at 30 June 2018;
 - 55.5. HCG's current liabilities were HK\$19.76 billion and total non-current liabilities were HK\$4.66 billion as at 30 June 2018;
 - 55.6. HCG's net assets were recorded at HK\$10.88 billion but had little or no material immediate net realisable value;
 - 55.7. HCG's total deposits, cash and cash equivalents decreased from HK\$784 million as at 31 December 2017 to HK\$352 million as at 30 June 2018; and
 - 55.8. HCG only received total new orders of HK\$23 million during the first half of 2018, which was immaterial (3.7%) relative to new orders of HK\$619 million for the year ended 31 December 2017.
56. HCG's 2018 interim report reveals that HCG has not been able to obtain extensions of its overdue borrowings of HK\$5,064 million (which include the 2018 Notes and 2019 Notes) from the lenders. These borrowings would be immediately repayable upon demand by the lenders and are all classified as current liabilities as at 30 June 2018.
57. On 31 August, Hing Ming Gondola (HK) Company Limited has commenced 2 legal actions, one at District Court claiming against HCC for outstanding service fees for HK\$0.6 million in DCCJ 3898 / 2018 and one at High Court claiming against Hsin Chong Construction (Asia) Limited for outstanding service fees for HK\$2.64 million in HCA 2055 / 2018.

Meeting of Finance Committee held on 8 December 2017

Transcript of the reply made by Mr Duncan Pescod, CEO of the West Kowloon Cultural District Authority, for the period between 00:49:00 and 00:52:45

[00:49:00]

Jeremy Tam: 主席，我想詢問關於今次撥款之後工程監管的問題。你們會否留意一下承辦商的財務是否健康，並不是只指公司在招標時的財務健康，而是指一旦中標後，往後會否監管公司的財務健康，確保財務健康並能夠完成工程。謝謝主席。

[00:49:37]

CEO: Thank you, Mr. Chairman. Yes, indeed. This is in fact one of the most important aspects of the contract management that we have. We have a system of independent contract management: they are responsible to us to ensure that on a weekly and monthly basis, all of the funding requests are submitted; they're checked; they're verified before they're passed on. So that is an ongoing process, and it's something that we actually consider to be functionally central to the way we manage these contracts, and I can assure members we will continue to do that going forward.

[00:50:17]

Jeremy Tam: 主席，在西九工程中，過往是否曾有承辦商出現財政問題，令到你們知道出現問題。到目前為止是否曾經有這種個案？多謝主席。

[00:50:36]

CEO: As far as the contractors that we're having on site at the moment, they are all the original contractors; they're all continuing to work. We do work with the contractors on a regular basis; we have a dialogue with them to make sure that they have the resources to allow them to pay their subcontractors, pay their staff and what have you. It's a difficult one to answer in the sense that all I can talk about is in respect of the work that they do for us, and I can assure you that that work is continuing apace. And as I said before, if members would like to see for themselves, you're very welcome to come down to the visit we're organising later this month.

[00:51:18]

Jeremy Tam: In this case, I can confirm that I mean all the main contractors or subcontractors are actually in a healthy state in terms of financially, and all the worker is paid as according...

[00:51:31]

CEO: I can certainly confirm that as far as our checking is concerned, all the workers are being paid on time. I can also confirm that as far as our checking is concerned, the contractors that are working on our site currently have the resources to continue their work, but as I said, I'm not giving any guarantees on other sites outside our site.

[00:51:55]

Jeremy Tam: But at least, I be like, that has been confirmed that until today, this time, I mean like, all the contractors is actually in a healthy state, I mean that is the main thing that I want to ensure. And I would like to see that to be continued if this funding has been approved, I hope the government will continue to monitor all the subcontractor and the main contractor, because the important part is we need to ensure all our workers are actually being paid, you know, as scheduled. That is the major thing, I mean, they have families too.

[00:52:27]

CEO: Of course. And I fully support that. And I can assure you that that is always our objective: to make sure that both the contractors, their subcontractors—which are equally important—and their staff are paid on time.

Meeting of Finance Committee held on 5 January 2018

Transcript of the reply made by Mr Duncan Pescod, CEO of the West Kowloon Cultural District Authority, for the period between 01:01:49 and 01:06:27

[01:01:49]

Jeremy Tam: 多謝主席。我想問一件事，其實我在上一次會議亦曾問過，究竟承辦商的財政是否健全。於上次會議中，政府方面曾回答全部都很正常、很健康，工人亦收到錢，但其實我是曾收到投訴的，我收到最少有三名人士向我表明，其實現在西九的承辦商，應該其中一個是新昌，而新昌這一個承辦商有財政問題，導致到他們很多工友收不到薪金，而亦都有說是其實他們的支薪方法而改由西九管理局直接支薪予那些員工。我想證實一下是否真有其事？謝謝主席。

[01:02:51]

CEO: Thank you, Mr. Chairman. I think, at the last meeting, actually, I commented on this item and I said at the time that as far as we're concerned, the payments are going to the workers. I in fact subsequently checked after the meeting to make sure that those payments were going to the workers through the contractor and subcontractor, and I can confirm that those payments are being made on a monthly basis. In fact, the arrangements that we have put in place are to ensure that the project continues and that workers are continued to be paid, so that's the arrangement we have in place, yes.

[01:03:30]

Jeremy Tam: 我的問題是，現在是誰負責付款？

[01:03:35]

CEO: Of course, the subcontractors and contractors are responsible for paying the wages. Our responsibility is to ensure that they pay the wages, so we receive from them the receipts from those subsequent payments to the workers and we monitor that very closely.

[01:03:55]

Jeremy Tam: 即是說新昌這一間公司是沒有財政上的問題，會令西九管理局有任何的擔憂，可不可以這樣去理解？

[01:04:06]

CEO: Mr. Chairman, I certainly would never comment on the financial stability of a listed company. All I can say is that as far as I'm concerned, the payments are going out to the contractors and the subcontractors and they are being paid to the workers.

[01:04:21]

Jeremy Tam: Okay 那是否即是你在否認西九管理局直接支付薪金給那些員工？

[01:04:30]

CEO: Mr. Chairman, we don't have a direct relationship with those workers. As I say, our relationship is with the contractor, and through the contractor, the subcontractor, and we work through that relationship.

[01:04:42]

Jeremy Tam: Okay 好。因為正如剛才所說，我是曾收到投訴的。因為就先前提到的建築商是有財政問題。而我翻查一些新聞，其實他們在去年亦有一些財政問題、一些股東的轉換、入股等等。而亦都有員工向我表示，他們收不到薪金。我可以直接告訴你，例如 M+鋪設地板的人，他們說已有三個月收不到薪金，我不知道發生甚麼事。而亦都有說已經不是由剛才所說的承辦商支薪給他們，而是由西九直接支薪給員工。因為正常來說應是承辦商先支薪給員工，西九再根據收據付款給承辦商。現在是變成是你們直接支薪給員工，這是投訴人對我說的。當然我是需要向你們印證的，所以我是希望知道是不是曾有這種事。多謝主席。

[01:05:55]

CEO: Mr. Chairman, I can confirm we don't pay anyone other than our own staff directly. We pay the contractor, the subcontractor, and we ensure that they pay the workers; that's the arrangement, so I can confirm we do not pay workers that are employed by other companies. That's not an appropriate arrangement.

[01:06:13]

Jeremy Tam: 主席，我希望可以很快再問一句，希望你們回去後可以再了解 M+ 鋪地板的員工是否真的已有兩、三個月沒有收到薪金，還有好像不止是薪金，好像連物料的費用你們也還未向他們付款。

[01:06:26]

CEO: I will do that.



The Hong Kong E&M Contractors' Association Limited
香港機電工程商協會有限公司

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2018 年 7 月 20 日

陳淑莊議員台鑑
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立法會綜合大樓 814 室

尊敬的陳淑莊議員:

關於西九文化區 M+博物館工程款項支付安排事宜

香港機電工程商協會(簡稱「協會」)為香港機電工程商聯會(簡稱「聯會」)轄下的六個主要機電商會之一。協會會員包括業內各主要承辦商，共同承接的金額佔業內六至七成以上，協會旨在推動行業發展，積極代表機電業發聲，為香港的繁榮發展作出貢獻。

聯會於 7 月 18 日去信 陳議員就西九文化區 M+博物館工程款項支付安排事宜交流看法。本人 謹此代表協會會員，進一步向 閣下分享對相關款項支付安排的意見，以釋除疑慮。

建造業是香港發展的主要支柱之一。多年來有賴業界各持份者的默默耕耘，推動公營基建以至私人項目的開發，促進本港的經濟及民生的發展。工程分判制度是香港建造業長久以來的運作模式，發展商、總承建商及分判商共同履行責任，確保工程能順利進行及保障前線工人的生活。

在一般情況下，發展商按合約支付總承建商，總承建商再按合約支付分判商。但如果總承建商因各種原因暫時未能履行付款的責任，在與發展商磋商及雙方同意下，發展商可調整付款安排，先代總承建商向分判商支付已經核實工程所涉及的費用。現時，社會各界擔心西九文化局的做法會否涉及工程的額外開支及浪費公帑，如聯會所解釋，當中並不會因為支付工程款項的角色轉換而導至西九文化局多付工程款項，總承建商(新昌)免支付款項，或令分判商多收工程費用的情況出現。

反之，這個靈活的安排可避免工程款項的爭議，及防止工程橫生枝節拖垮進度，分判商和工人亦可以安心施工。基於對整體社會的福祉考慮，我們認為是可取及符合大眾利益的做法。

.../P.2



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2018年7月20日
陳淑莊議員台鑑
P.2

社會亦關注工程監察角色模糊或施工管治的問題。我們認為付款安排的改動並不會影響工程持份者的責任。總承建商仍要繼續承擔商業風險，履行合約的責任，監督分判商的施工，確保工程的安全、質量和進度。

事實上，業內持份者因付款的爭議而出現拖延付款的問題屢見不鮮，為了確保業界有健康的發展，我們與聯會立場一致，支持付款保障條例的立法，以提供迅速排解付款爭議的方法。

坦誠的溝通有利共建和諧社會，我們冀望與閣下就以上的課題或行業其他議題作深入的意見交流，促進行業的健康發展。

祝
身體安康

香港機電工程商協會會長
曾慶祥 (Gilbert Tsang)

副本抄送(電郵)
立法會主席及全體議員
西九文化區管理局主席及行政總裁
發展局局長及常任秘書長(工務)
香港建造商會會長

日期：2018 年 7 月 18 日
編號：FEMC-18-EXA-010

陳淑莊議員台鑑
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尊敬的陳淑莊議員，

關於西九文化區 M+博物館工程款項支付安排事宜

香港機電工程商聯會 (HKFEMC 以下簡稱聯會) 是本港六個主要機電商會的聯合平台，包括：

1. 香港機電工程商協會(EMCA)
2. 電梯業協會(LECA)
3. 香港電器工程商會(ECA)
4. 香港空調及冷凍商會(ACRA)
5. 香港水喉潔具業商會(PSTWA)
6. 香港註冊消防工程公司商會(FSICA)

會員業務覆蓋全港不同規模及種類的公共及私人工程，是廣受各方認受的業界代表，一直與持份者積極溝通互動去促進社會繁榮及推動行業發展。

聯會十分贊賞 閣下對西九工程項目款項支付安排的關注，日理萬機仍然能注意到貼地的行業及民生議題，實在難得，不負選民所託！

建造業的生態比較特殊，由總承建商到前線工友，中間少則有兩三個層次的分判，多則五六。分判結構是專行專業分工及生產力最優化的自然產物，非人為所致，也不可能人為改變。但無論生產鏈的結構如何，資金流的模式只有一個：由食物鏈最上層的發展商發放給第二層的承判商(數目可以為一個或多個)，然後層層向下分放，直至最前線的工友。

若然第二層的承判商只有一個，則稱為總承判商，M+博物館項目屬此類，總承判商就是“新昌”。

正常的工程款項審批及發放程序：

- 分判商每月將完成的工程量及相關價值向上層遞交，由總承建商審核及調整再整合送交發展商；
- 發展商審核及調整後通知總承建商，再按合約支付期發放；
- 總承建商收到款項後按分判合約支付期發放予分判商，然後層層下達。



日期：2018年7月18日
編號：FEMC-18-EXA-010

偶有總承建商因各種原因未能依期發放糧款，發展商權衡輕重後會和總承建商協議從應付款中扣起部份代其支付主要分判商，維持整條食物鏈資金流的暢順，讓工程能繼續開展直至情況改善，這種務實的全贏措施並非罕見，尤其是在私人項目。

發展商確實要投入較多的資源去管理這種支付模式，但卻不會因而承擔較高風險或多付工程款項。所有付予主要分判商的款項都是從原來就應該付予總承判商的糧款中扣除，一分也不會多。主要分判商亦只能收到總承建商本來就同意支付的糧款，這種情況下金額一般都會傾向保守，只有少收，絕無超收可能。而且總承建商亦會簽訂同意書確認所有支付予其分判商的款項等同已按原合約支付予總承建商，再無追討的權利。總承建商按原合約對發展商的所有責任和義務完整保留，包括分判商的工程質量和進度。

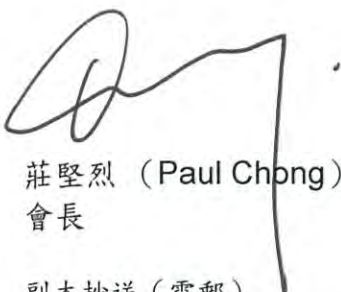
發生這種情況當然非發展商所樂見，但任由生產鏈的資金流崩潰，最終必導致項目失敗，重新招標採購的經濟損失及工期延誤案例比比皆是。

西九文化局的果斷決定是今天彌漫推塘塞責風氣的病態社會難見的一服清涼劑，其務實，專業及勇於承擔的精神和行為完全值得肯定，表揚及讚賞；並應予以鼓勵推廣，矯正窒礙進步的但求自保不顧大局歪風，強化行業活力，效率及團隊精神，為香港再創高峯發光發熱。

不拘死條正氣承擔的機構不幸在現實社會中只屬極少數，要把行業的生態理順讓持份者公平競爭及健康發展，健全的法制才能給予較全面的支援。暢順的資金流是建造業最關鍵的元素，業界引頸以待的“付款保障法案（Security of Payment Act）”已進入最後撰寫階段，期望不久就能呈交立法會審批。

聯會盼望能與閣下及其他議員就行業各個課題交流，包括上述的特殊付款安排及立法保障，雙方增進了解，令有利整體民生的政策及措施能更有效地落實。

恭候覆示！



莊堅烈（Paul Chong）
會長

副本抄送（電郵）

- 立法會主席及全體議員
- 西九文化區管理局主席及行政總裁
- 發展局局長及常任秘書長（工務）
- 香港建造商會會長
- 香港建造業分包商聯會會長
- 香港建造業總工會理事長
- 香港機電業工會聯合會主席

Translated version of HKFEMC letter sent to The Hon. Tanya Chan

The Honorable Tanya Chan

Legislative Council Complex
1 Legislative Council Road
Central, Hong Kong

18 July, 2018

Dear the Honorable Ms Tanya Chan,

**Re: West Kowloon Cultural District (WKCD), M+ Museum
Arrangement of Payments for Construction Work**

The Hong Kong Federation of Electrical and Mechanical Contractors (HKFEMC) is the common platform of the six major electrical and mechanical contracting associations in Hong Kong, namely:

1. The Hong Kong Electrical & Mechanical Contractors' Association
2. The Lift and Escalator Contractors Association
3. Hong Kong Electrical Contractors' Association
4. The Hong Kong Air Conditioning & Refrigeration Association
5. Hong Kong Plumbing & Sanitary Ware Association
6. The Association of Registered Fire Service Installation Contractors of Hong Kong

The HKFEMC is widely recognized as the representative body for the electrical & mechanical contractors because its services to members have comprehensively covered all public and private construction projects of diverse types and sizes. As such, HKFEMC has been actively involved in communicating and working with various stakeholders of the construction industry to promote healthy development of the industry and prosperity of society at large.

We are very appreciative of the devout attention you have paid to the payment arrangements for the WKCD construction works. It is indeed highly commendable that in spite of your extensive service to society and a grueling work schedule, you have been able to focus on problems that affect the livelihood of the working people. This devotion certainly deserves the support of your voters.

The construction industry indeed has some rather unique traits. Between the main contractor and the front line worker there are usually several layers of subcontracting, from a minimum of 2 or 3 layers to as many as 5 or 6. This subcontracting structure is a natural end product of the specialized nature of the construction industry, whereby specialized trades call for specialized skills. The structure is a product of an evolution driving for high productivity and efficiency. It was not designed by any grand master, and cannot be changed by mere mortals. However, regardless of what the production model is, there is only one single model for the food chain: Cash flow starts from the very top layer, the Developer, then goes to the contractor (or contractors) at the second layer. It then further divides and gradually flows to the lower layers, until it finally reaches the frontline workers.

If there is only one contractor at the second layer, that contractor is called the Main Contractor. This is the case with the M+ Museum Project, where the Main Contractor is "Hsin Chong".

Under normal circumstances the procedure for the approval and disbursement of payments for construction work is as follows:

- The subcontractors will submit to the contractor one level above the amount of work completed and its value in dollar terms. All their submissions eventually end up with the Main Contractor, who then checks them and makes his adjustments before submitting to the Developer in its final form.
- The Developer checks the submission, makes his adjustments and then informs the Main Contractor, then makes payment to the Main Contractor according to the time frames as specified in the contract.
- The Main Contractor, on receipt of the payment, pays the sub-contractors in accordance with the time frame as stipulated in the contracts with his sub-contractors. The sub-contractors then pay their sub-contractors who are one level below them in the food chain. The money flows further down to the lower levels in similar manner.

When the situation arises whereby the Main Contractor for some reason cannot make payments for salaries and wages within the required time frame, the Developer would evaluate the circumstances and, after consultation with the Main Contractor, take the option of withholding part of the payment to the Main Contractor and use the withheld amount to pay the major sub-contractors directly. The purpose is to maintain a smooth and uninterrupted cash flow down the food chain, in order that the work can continue, until the situation has sufficiently improved. Such pragmatic practices to achieve win-win situations are not uncommon, especially in private projects.

The Developer would of course have to devote more efforts and resources to manage and administer this mode of payment, but he would at the same time avoid taking on extra risks on the project, including paying more than necessary for the work done. The Developer does not pay a cent more than necessary because every dollar he pays the sub-contractors is deducted from the sum that he would have to pay the Main Contractor anyway. Likewise, the major sub-contractors only receive from the Developer what are already due to them by the Main Contractor. As valuations of such payments are always on the conservative sign, the amounts paid are usually less than the amounts due. Thus there is no question of over payment.

To ensure that the Main Contractor does not have redress on such direct payments, the Main Contractor would have to sign an agreement whereby he confirms that the payments made by the Developer to the sub-contractors are equivalent to payments having been made to the Main Contractor in accordance with the contract. Furthermore, all the Main Contractor's responsibilities and obligations to the Developer under the contract remain intact with the Main Contractor, including the progress and quality of the work of the sub-contractors.

Situations like this are not what Developers like to see. But if the cash flow down the food chain breaks down, the project is bound to fail. The market is not short of examples of long time delays and huge economic losses for projects that had to go through re-tenders to complete the procurement process.

The bold decision of the West Kowloon Cultural District Authority (WKCD) on payment arrangements is like a fresh breeze across the stale atmosphere of society today, where procrastination and shifting blame are more prevalent. WKCD's pragmatic, professional and responsible attitude and action are worth our recognition, appreciation, and praise. One should also broadcast and encourage such work attitude, to drive away the stale atmosphere of non-action and obfuscation which hinders progress, and in its place to regenerate energy, efficiency and team spirit in the construction industry, and to help propel Hong Kong to new heights.

Unfortunately in the real world socially responsible and pragmatic institutions are few and far between. Thus if we want to instil a proper order in the construction industry whereby all stakeholders can partake in fair competition and healthy development, a robust legal system would be necessary to provide the necessary framework. The key element for the industry under this framework would be 'smooth cash flow'. In this respect, the Government's "Security of Payment Act" is now in its finishing drafting stage. We hope that it will be submitted to the Legislative Council soon.

In closing, we hope that HKFEMC can further exchange views with your good self and your Legco colleagues on the above mentioned payment arrangement and security of payment, and indeed other issues, to foster mutual understanding, and enable policies and measures related to people's livelihood to be more effectively formulated and promulgated.

Yours Very Sincerely.

Paul Chong
President

cc. (by email)

- The Chairman and all members of the Legislative Council
- The Chairman and Chief Executive of the WKCDA
- Secretary for Development
- Permanent Secretary (Works), Development Bureau
- President of Hong Kong Construction Association
- President of Hong Kong Construction Sub-contractors Association
- The Chairman of Hong Kong Construction Industry Employees General Union
- The Chairman of the Federation of Hong Kong Electrical and Mechanical Industries Trade Unions