

**For Discussion on
28 November 2023**

Legislative Council Panel on Development

Construction Industry Security of Payment Bill

Purpose

This paper briefs Members of the proposed Construction Industry Security of Payment Bill (“Legislation”) to improve the payment practices in the construction industry, and to provide a mechanism for speedy resolution of payment disputes, with a view to improving the cash flow problems encountered by stakeholders along the supply chain in the construction industry.

Background

2. The construction industry is an important impetus to promote economic growth and social development in Hong Kong. It also provides livelihoods for hundreds of thousands of labour force. There is a wide coverage of construction works¹ involving participation of different stakeholders, including owners, contractors, subcontractors, works consultants and suppliers, etc. Construction works involve a variety of professions/ trades and there are unique features for individual projects. It is difficult for individual contractor (or works consultant) to rely on its own resources to undertake the entire works (or services). To enhance the flexibility in works procurement, subcontracting arrangement is commonly adopted in the local construction industry. Stakeholders often need to use their own capitals to commence the works, and then receive payments for the works, professional services, materials, plants and/ or equipment, etc. from the paying parties in accordance with the works progress and the payment

¹ Including site formation, infrastructure facilities, railways and housing construction, etc.

terms in contracts. Since many works projects involve large amount of capitals, smooth cash flow for stakeholders in the supply chain is very crucial for effective implementation of the works. To ensure the smooth implementation of the works, it is necessary to enhance the security of payment to stakeholders in the construction industry.

3. The construction industry has been looking forward to the Government to set up a security of payment system. While many large-scale works projects (including the Northern Metropolis, Kau Yi Chau Artificial Lands, railways and roads, public and private housing development and public hospitals development, etc.) will be progressively launched in Hong Kong, the Construction Industry Council forecasts that the total annual construction expenditure in Hong Kong will increase from about HK\$250 billion to over HK\$300 billion in the coming years. It is crucially important for the establishment of aforesaid system at this moment.

Justifications for Legislation

4. To acquire a better understanding of the payment practices of the local construction industry, the Development Bureau (“DEVB”) engaged a professional consultant to carry out a comprehensive and industry-wide survey in 2011 and a follow-up study in 2023. It was revealed that stakeholders along the supply chain in the construction industry, including the contractors, subcontractors, works consultants and suppliers, etc. have been experiencing payment problems to different extents across the years. The average outstanding payment per annum accounted to 5% to 12%² of the total business receipts, and the longest delay in payment was over 6 months. The industry generally considered that there has been no noticeable improvement to the payment problems over the last decade.

5. According to the above-mentioned survey and study, the major root causes of the payment problems are as follows :

² According to the result of the survey, the average outstanding payment per annum of the contractors, subcontractors, works consultants and suppliers accounted to 8%, 12%, 10% and 5% of the total business receipts respectively.

- It is common in the construction subcontracts that even though the claiming party has already completed the works or provided the services in accordance with the contract, they can only receive the payment after the paying party gets paid from an upper-tier contract (i.e. “conditional payment terms” or “pay when paid”). It often results in a serious delay for the claiming party to receive the entitled payment.
- For some construction contracts, payment arrangement has not been specified, which includes no provisions of the number and interval of payments, payment deadline, etc. This practice is more likely to occur in contracts with lower-tier subcontractors, which renders the paying party delaying the payment.
- There may exist disagreement over the payment amount and the extension of time between the paying party and the claiming party, resulting in dispute. According to general terms of a contract, in case a consensus between the two parties cannot be reached by negotiation or mediation, the payment dispute has to be settled through litigation in courts or arbitration, which will only happen after the completion of the entire works under the contract. Litigation or arbitration is usually costly and involves very long processing time. Besides, before the dispute is ruled, the claiming party is still bounded by the contract to continue working and financing the works, resulting in an extra financial burden on them. This harms small and medium sized enterprises in particular. When the situation becomes serious, the claiming party may not be able to fulfil the contract requirements and the financial responsibility over the party to lower-tier contract, causing problems like wage default and insolvency, etc.

6. The above-mentioned payment problems in the construction industry are not unique in Hong Kong. Many countries have already adopted legislative approach to tackle the payment problems to ensure all stakeholders along the supply chain in the construction industry to timely receive their entitled payments. In order to solve the payment problems in

the construction industry, the DEVB established a Task Force for Preparation of Legislative Proposals to the Construction Industry Security of Payment Ordinance (“Task Force”), comprising of members from related government departments, public and private organizations and industry representatives, in 2016. It also studied the security of payment legislations in other countries, and considered the public consultation opinions, with a view to progressively taking forward the legislative work. The industry has all along supported the use of legislative approach to solve the payment problems in the construction industry as soon as possible.

Legislative Proposals

7. The major proposals in the proposed Legislation include improving the contract payment terms, introducing a mechanism for speedy resolution of interim payment disputes, and empowering claiming party to suspend or reduce the rate of progress of the work in specific circumstances of non-payment. The coverage and the details³ of the proposed Legislation are stipulated as follows:

Coverage of the Legislation

8. The proposed Legislation will cover all construction works contracts, as well as contracts of services, supply of materials and plants, etc. in relation to the construction works⁴ (hereinafter referred to as “Construction Contracts”), with the main contract values not less than the threshold value⁵, procured by **the Government and specified bodies from the statutory and**

³ The construction industry security of payment legislations established in other countries generally also include improving contract payment terms, introducing adjudication mechanism for speedy dispute resolution, and empowering the unpaid party to suspend or reduce the rate of progress of works.

⁴ Construction works include :

- (a) Construction, alteration, repair, restoration, renew, maintenance, addition, demolition or dismantling of buildings or facilities (facilities include e.g. slope, retaining wall, road, aviation, shore or harbour protection, electricity/ fuel gas/ gas supply, telecommunication, water supply, drainage, sewage treatment, waste treatment facility, etc.).
- (b) Works in relation to the completion of the above-mentioned buildings or facilities, e.g. electrical and mechanical, drainage, water supply works, etc.
- (c) Relevant procedures or temporary works in relation to the above-mentioned works, e.g. site investigation, excavation, provision of scaffolding, etc.

⁵ If the main contract is a works contract, the threshold value is proposed to be HK\$5 million. If the main contract is a service, materials and plants supply contract, the threshold value is proposed to be HK\$0.5 million.

public organisations/ enterprises (hereinafter referred to as “Specified Bodies”⁶).

9. The proposed Legislation will cover the following **Construction Contracts in private sector**:

- Construction Contracts for new works, with main contract values not less than the threshold value;
- Construction Contracts for works on existing buildings/ facilities , with main contract values not less than the threshold value , but not including Construction Contracts of existing residential buildings (e.g. interior renovation, building maintenance, etc.), and Construction Contracts for works not requiring approval⁷ of the Building Authority under the Buildings Ordinance, on existing non-residential buildings (e.g. maintenance and repair of building services installation, shop renovation, etc.).

10. The exclusions from the coverage of the proposed Legislation are mainly Construction Contracts procured by the general public and small-sized enterprises. These people are generally not familiar with the Construction Contracts and relevant legislations, and it is practically difficult⁸ for them to comply with the requirements of the proposed Legislation. After detailed consideration, the Task Force came up with a unanimous agreement that the coverage of the proposed Legislation has already struck a balance between the provision of security of cash flow for the stakeholders in the industry and the reduction of nuisance to the public.

11. With regard to the application of the threshold values, we propose to apply them on the main Construction Contracts. Should the main

⁶ “Specified Bodies” includes Airport Authority, the Hong Kong Housing Authority, Hospital Authority, MTR Corporation Limited, Electricity or Town Gas Suppliers, etc.

⁷ Including the minor works commenced under the simplified requirements of the Buildings Ordinance.

⁸ It is generally more difficult for the owners’ corporations of private residential buildings to reach a consensus on contract administration, handling payment disputes, etc. There is a relatively stringent timing requirement for the payment arrangement and adjudication proceedings under the Legislation (for details, see paragraphs 12 to 14 of this Paper). Under the condition of multiple ownership, the owners may not be able to provide rapid responses.

Construction Contract be covered under the proposed Legislation, all subcontracts or service contracts along the same supply chain will be bounded by the proposed Legislation. Besides, the proposed Legislation will cover both written contracts and oral agreements since many local small-sized contractors and subcontractors adopt oral or partly oral agreements in undertaking the construction works.

Improvement of Contract Payment Terms

12. The proposed Legislation will impose restrictions over some unfair payment terms, including rendering the contract term “conditional payment” ineffective, and requiring the paying party to respond to a payment claim within 30 days and to settle the payment within 60 days upon receipt of the payment claim from the claiming party, in order to ensure that the claiming party can timely receive the entitled payment. Under the proposed Legislation, the parties to the contract, on the basis of not violating the above-mentioned stipulation, could still enjoy a high degree of freedom to agree on contract terms, including the payment schedule and the assessment of the payment amount, etc. However, if the contract does not specify the above-mentioned terms, the claiming party will be entitled to submit payment claim on a calendar monthly basis, and to assess the payment amount in accordance with the works and services carried out.

Introduction of Adjudication Mechanism

13. The proposed Legislation will introduce an adjudication mechanism. The proposed Legislation defines that a payment dispute has arisen between the parties to the contract if the paying party fails to serve a payment response within the deadline, or fails to pay the admitted amount in full on or before the payable date, or the claiming party disagrees with the amount of payment stated in paying party’s payment response. Under these circumstances, the claiming party is entitled to initiate adjudication proceedings for the payment dispute. The parties to the contract could engage an independent adjudicator appointed by an Adjudicator Nominating Body (“ANB”)⁹ registered under the proposed Legislation, to adjudicate the payment dispute and to make a

⁹ ANB is a body registered by the DEVB, and is responsible for stipulating the eligibility requirements of the adjudicators, establishing a register for the adjudicators and formulating nomination procedures, in order to appoint suitable adjudicators to handle the payment disputes. The Legislation will empower the Secretary for Development to approve the ANB.

rapid and binding determination.

14. Proposed adjudication mechanism is as follows:

- A claiming party must initiate the adjudication proceedings within 28 days after the date on which a payment dispute arises. The claiming party serves an adjudication notice to the paying party and the ANB, stating the relevant information, nature and description of the dispute, as well as the dispute amount, etc.
- The ANB must provide to both parties to a contract the adjudicators for selection within 3 working days. The ANB then appoints a suitable adjudicator¹⁰ based on the replies from both parties. The entire nomination process must be completed within 7 working days.
- Both claimant and respondent must serve on the adjudicator the submissions and the relevant supporting evidences within the deadline as specified in the proposed Legislation or set by the adjudicator. The adjudicator must determine, including the amount to be paid by the paying party and the payment deadline, the number of days involved in the extension of time, as well as the costs of the adjudication proceedings to be paid by the parties, etc., within 55 working days¹¹.
- In case the paying party fails to pay in accordance with the adjudicator's determination, the claimant can submit to the Court of First Instance an enforcement application.
- Both parties' rights to refer the dispute to arbitration or to court for litigation if they are dissatisfied with the adjudicator's determination remains unaffected. However, the adjudicator's

¹⁰ The qualifications for adjudicators include professionals with the relevant experience relating to construction contract administration or works disputes resolution, as well as with no conflict of interest with both parties to the contract.

¹¹ If both parties agree, the 55 working-day deadline can be extended.

determination is still valid until the final determination is given by arbitration or the court.

15. Nowadays, generally in a contract, the contractor is entitled to an extension of time and compensation of related additional expenses under specific circumstances. It is generally more complicated to assess the contractor's entitlement to the extension of time and related compensation amount. Besides, adjudication is a new mechanism for resolving payment disputes in the construction industry in Hong Kong. After consulting the Task Force, it is proposed that the adjudication of payment disputes in relation to the extension of time will be implemented progressively in two phases under the proposed Legislation. The first phase will be implemented in the public sector (including the Government and specified bodies). When the adjudication mechanism becomes well-developed, the Secretary for Development will specify the effective date for implementation of the second phase in the private sector.

Suspension or Reduce Rate of Progress

16. The proposed Legislation will stipulate that under specific circumstances, including that the paying party fails to pay to the claiming party the admitted amount in full on or before the payable date, or after the payment dispute is determined by adjudication and the paying party fails to pay the adjudicated amount in full within the deadline, the claiming party is entitled to suspend or reduce rate of progress of the works. However, under other circumstances, such as, the parties simply disagreeing on the payment amount, or adjudication for dispute on payment amount being underway, the claiming party will not be entitled to suspend or reduce rate of progress of the works.

17. The claiming party must, at least 5 working days prior to the intended starting date of exercising the right for suspension or reducing rate of progress of the works, serve on the paying party in writing a notice of intention, as well as notify the owner (i.e. the party procuring the main construction contract), in order to prompt the paying party to fulfill the responsibilities as soon as possible, and to allow the owner to better understand the situation and intervene, if needed, as early as possible to help

the parties settle the payment dispute. Once the claiming party receives the respective outstanding payment, the claiming party must resume the works within 7 working days.

18. Under the proposed Legislation, the claiming party is also entitled to an extension of time to complete the contract and be paid for any loss and expenses incurred as a result of exercising the right to suspend or reduce the rate of progress. This proposal ensures that under the specific circumstances of non-payment, the claiming party does not need to be obliged by the contract to continue working or financing the works, thus alleviating their unnecessary financial burden and risk.

Implementation of the Legislation

19. We propose that the Legislation will apply to construction contracts newly signed one year after gazette since a series of preparation works¹² will be carried out before the Legislation comes into force.

Way Forward

20. We are finalising the legislative proposal of the Bill, and seeking to submit it to the Legislative Council in the first half of next year for consideration for enactment.

Advice Sought

21. Members are invited to take notes of the content of this Paper and offer views.

Development Bureau

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¹² The preparation works include registration of the ANB, and the registered ANB is required to stipulate the eligibility requirements of the adjudicators, as well as to establish a register for the adjudicators and formulate nomination procedures, etc. Besides, after the passage of the Legislation, it will take a period of time for the industry to review and adjust the current contract terms in order to comply with the requirements of the Legislation.