

Insights

THE NEW SECURITY OF PAYMENT REGIME IN HONG KONG – KEY ISSUES TO CONSIDER BEFORE ITS IMPLEMENTATION

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SUMMARY

With the Hong Kong Development Bureau's (DevB) contractual security of payment regime coming into effect from 31 December 2021 (the SOP regime), we now examine some important challenges which facing the Hong Kong construction industry as it comes to grips with the new contractual environment. The SOP regime is set out in the [Technical Circular \(Works\) No.6/2021](#) published by DevB on 5 October 2021 for the implementation of security of payment provisions in public work contracts (the Circular) and will take effect in two stages, commencing on 31 December 2021 and 1 April 2022. For our earlier articles looking at the particulars of the SOP regime, please see [Security of Payment in Hong Kong - pilot programme for public works contracts](#) and [Security of payment circular issued by the Development Bureau of Hong Kong – to take effect from 31 December 2021](#).

With the issue of DevB's Circular implementing a contractual SOP regime for Hong Kong public works contracts and sub-contracts starting from 31 December 2021, the need to prepare for the Circular's impact is intensified. It is therefore worth taking a deeper look at the issues and challenges presented by the SOP regime as currently implemented by DevB, and consider how these challenges might be best met.

In this article, we will further consider (i) the direct payment mechanism, (ii) the lack of judicial supervision under the current DevB regime, (iii) the importance of a system for ensuring adequately skilled and trained adjudicators, and (iv) the time periods relating to payment and adjudication.

THE DIRECT PAYMENT MECHANISM

The direct payment mechanism entitles a sub-contractor (of any tier) to request the Government as employer to make direct payment for any unpaid adjudicated amounts. It has been introduced to address the lack of a (statutory) enforcement mechanism through the courts.

Briefly, where a sub-contractor submits a copy of an unpaid adjudication decision to the Government, the Government will pay all or part of the adjudicated amount to that claiming sub-contractor and then make a corresponding deduction from payments due to the main contractor - unless the main contractor can show that the adjudication decision has already been satisfied or is no longer binding, or that the deducted amount cannot be recovered from sub-contractors at a higher tier to the claiming sub-contractor. If Government makes such a deduction from the main contractor, then the main contractor, and in turn, the sub-contractors at a higher tier to the contractor that failed to pay as required by the adjudication decision, are entitled to recover the direct payment amount by making corresponding deductions down the sub-contracting chain.

Unlike the direct payment mechanism under the Employment Ordinance (Cap. 57) which caps a main contractor's liability for unpaid wages to the employees of its subcontractors at two months' wages and excludes liability for the wages of employees of nominated subcontractors entirely, there is no limitation on a main contractor's liability under the DevB model.

Clearly the direct payment mechanism places a substantial burden on main contractors, as they bear the primary burden of payment failures at any subcontract tier.

JUDICIAL OVERSIGHT?

In jurisdictions where security of payment is governed by statute, parties have (comparatively) quick and ready access to the courts to enforce or challenge adjudication determinations. However, without a statutory underpinning to the contractual SOP regime, there is no direct access to the courts for a party to challenge an adjudication, for example, on the grounds of the adjudicator going outside of his or her jurisdiction or where a party considers it has not been treated fairly through the adjudication process.

As such, disputes arising out of an adjudicator's decision will be subject to the dispute resolution process provided for in the contract, which under Government forms of contract will be by way of arbitration. Such awards will be private and confidential, and may be challenged only in the limited circumstances.

While adjudication is intended to be a quick interim process, other jurisdictions (and indeed adjudicators in those jurisdictions) have benefited from guidance of the courts as to the extent of an adjudicator's jurisdiction and in relation to procedural matters. This has particularly been the case during the early days of the implementation of a new SOP regime. The Hong Kong courts' opportunity to opine publicly and give guidance on these issues will be extremely limited.

ENSURING ADEQUATE TRAINING AND SUPPORT FOR ADJUDICATORS

Adjudication is a relatively new process in Hong Kong. As a result, there are few experienced professionals in Hong Kong possessing extensive adjudication experience.

The experience on other jurisdictions has been that support will be required for adjudicators in the early days of implementation of the SOP regime. This will no doubt fall to the adjudicator nominating bodies (**ANB**). In this regard, measures adopted in other jurisdictions to address ongoing training and support for adjudicators are instructive:

- In New South Wales, the relevant SOP legislation incorporates a “Code of Practice”. This requires ANBs to ensure that the nominated adjudicator can demonstrate that they understand the applicable SOP legislation.
- Singapore maintains a “Code of Professional Conduct and Ethics” which requires ANBs to act with due diligence and care and to take reasonable steps to ensure the competence of their adjudicators.
- The Australian state of Victoria takes a more stringent approach. Its “Conditions of Authorisation” require adjudicators to have relevant qualifications, experience, and training. For instance, adjudicators must have at least five years’ experience either in managing construction contracts or in contract dispute resolution.

For quality control, some foreign ANBs require adjudicators’ decisions to be reviewed by a more senior adjudicator. Other ANBs make available an extensive database providing case law and past decisions to guide adjudicators. Still other ANBs have put in place a mentoring system so that a junior adjudicator can discuss their case with a senior adjudicator.

TIME PERIODS RELATING TO PAYMENT AND ADJUDICATION

The SOP regime is “long” in that the time periods in the payment and adjudication processes are generous when compared against other jurisdictions.

Under the Circular, the maximum payment period is 60 calendar days:

- This period is long when compared with other jurisdictions. In New South Wales, payment by an employer to its main contractor is to occur within 15 days of an admission that payment is due. In Singapore, the comparable period is 35 days.
- The period has been shortened when compared to the most recent public consultation in 2015, when the DevB had proposed an interim payment period of 60 calendar days and a final payment period of 120 calendar days.
- Many respondents to the consultation raised concerns about the potential impact such long periods may have on the efficacy of the regime in promoting project cash-flow, and advocated for shorter payment periods of 45 and 90 days respectively.

Likewise, a claimant has 28 days after the receipt of the payment response to commence adjudication:

- The comparable period in Singapore is seven days.
- Such 28-day period is the same as the period proposed in the 2015 public consultation for referring matters to adjudicator. The majority of the respondents appeared to support the 28-day period.
- DevB's stated reasons for the 28-day period is to allow claimants to better consider their position before commencing adjudication and to give additional time for negotiation between the parties. Whether these objectives will be achieved is yet to be seen – potential claimants may be reluctant to unreservedly participate in negotiation, for fear of prejudicing their position in any future adjudication.

LIVING WITH SECURITY OF PAYMENT

Given that the contractual SOP regime will come into effect on 31 December 2021 for larger Government contracts and then in April 2022 for the remainder of the Government contracts covered by the Circular, it is important for the industry to prepare for its impact and to ensure that internal processes and personnel are ready for the coming changes.

Main contractors will need to decide their approach to adjudication under their direct contract with Government particularly where it is faced with adjudication applications from its subcontracting chain.

Now that the regime has been published, the outcomes will only improve if the system is used as it is intended at every level. There is no doubt there will be some uncertainties and bumps along the way. However the Hong Kong construction industry's enthusiastic adoption of security of payment processes may also encourage a quicker transition to a legislative regime, providing greater certainty for the future of Hong Kong construction contract payment practices.

RELATED PRACTICE AREAS

- Commercial Construction & Engineering
- Litigation & Dispute Resolution

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