

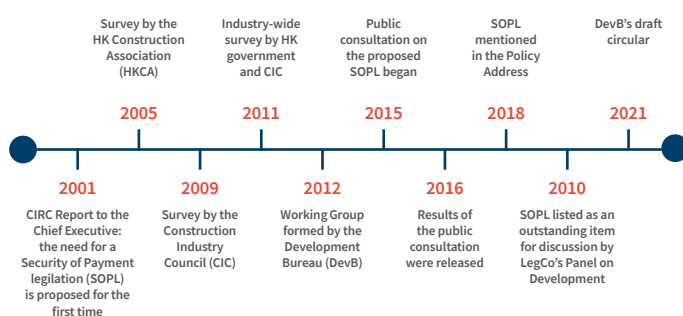


# SOP In Hong Kong – Pilot Programme For Public Works Contracts

As the old saying holds, cash-flow is the life blood of the construction industry. To ensure that cash-flow is protected, many jurisdictions have introduced SOP regimes to regulate payment practices and provide for rapid adjudication of payment disputes. In our experience, SOP regimes are usually implemented via legislation.

The first jurisdiction to enact a SOP legislation was the UK in 1998.<sup>1</sup> The UK was followed by other jurisdictions including various Australian states,<sup>2</sup> New Zealand,<sup>3</sup> Singapore<sup>4</sup> and Malaysia.<sup>5</sup> In Hong Kong, public discussion of SOP - related issues goes back to 2001, when the Construction Industry Review Committee publicly proposed that SOP legislation be enacted.<sup>6</sup> A non-exhaustive history of further developments relating to SOP in Hong Kong is provided in Figure 1 below.<sup>7</sup>

**Figure 1 - Timeline of the development of a security of payment legislation in Hong Kong**



## The Pilot Programme

In 2021, Hong Kong appears ready to implement a SOP regime for public works projects. This will take the form of a pilot programme applying to public works contracts and sub-contracts. To this end, the Hong Kong Development Bureau has released a draft Technical Circular titled “*Implementation of the Spirit of SOP in Public Works Contracts*”. This circular, if brought into effect, will incorporate SOP provisions into public works contracts and related sub-contracts.

The draft Circular indicates that the contractual regime will apply to public works contracts which go to tender during or after the second half of 2021. The regime will apply to contracts issued by the Hong Kong Government only and will not cover contracts issued by statutory bodies or corporations.

The pilot programme is intended to pave the way for the subsequent enactment of SOP legislation in Hong Kong. Based on current information, the final legislation is likely to affect all public works construction contracts (including contracts issued by specified statutory/public bodies and corporations) for procurement of construction work

or related goods and services. It is also likely that that the legislation will apply to private sector construction contracts with a value exceeding HK\$5 million (for works contracts) or HK\$0.5 million (for supply of goods and services, including professional services).

The initial limited deployment of a SOP regime in Hong Kong on a contractual basis, restricted to public sector activities, should provide the Hong Kong Government and the industry with an opportunity to test the regime and to identify snags or ambiguities in parallel with the development of the Security of Payment legislation.

Contractors will need to understand the effect of the new regime on their business, and dedicate time and resources to ensure that they comply with and effectively manage the Security of Payment requirements.

### The SOP Provisions

The Circular provides a set of provisions for incorporation into the relevant public works contracts. These provisions are known as the “*SOP Provisions*” and are set out in an annex to the Circular. The Circular further envisages that the SOP Provisions will be incorporated into the relevant public work contracts by Additional or Special Conditions of Contract.

The SOP Provisions set out a mandatory process for the administration and payment of progress payment claims. The Provisions also entitle the parties to the contract to refer any payment dispute to adjudication to determine the dispute on an interim basis.

The SOP Provisions include the following elements:

- The main contractor is entitled to submit a claim for a progress payment on or after the “Reference Date” specified in the Contract. The payment claim must state the amount claimed and the works, goods and services to which the claim relates.
- The employer is to serve a response to the payment claim within 30 days of the main contractor’s payment claim (or any shorter period specified in the contract). The response must state any amounts admitted as due, any disputed amounts, any set-offs or withholdings claimed (including the grounds on which any such set-off is based), and the net amount which the employer agrees to pay to the main contractor.
- Any amount admitted as due by the employer in its payment response must be paid within 60 days of the payment claim (or any shorter period specified in the contract).

- If a payment dispute arises between the main contractor and the employer, the main contractor may refer that dispute to adjudication within 28 days of the dispute arising.
- The adjudicator will have 55 working days from the date of his appointment (or any longer period agreed by the parties) to decide the payment dispute.
- The employer shall pay the amount decided by the adjudicator within 30 days after the adjudicator’s decision is delivered (unless the adjudicator directs otherwise).
- If the employer fails to pay an admitted or adjudicated amount by the due date, the main contractor will be entitled to suspend or reduce the rate of progress of its work.

The information included in the payment claim and response will establish the scope of any payment dispute that may later be referred to adjudication. Therefore, the employer and main contractors alike should ensure that the required documentation is prepared with care and include all necessary information – mistakes at this stage will prejudice a party’s position in any adjudication and could lead to an unfavourable adjudication determination.

### Mandatory Provisions For Inclusion In Sub-Contracts Connected With Public Works Contracts

The Circular also annexes “*Mandatory Sub-Contract Provisions*” for incorporation into all sub-contracts of any tier engaged under a relevant public works contract. The Mandatory Sub-Contract Provisions largely correspond to the SOP Provisions, with some notable differences which are described below.

Firstly, the Mandatory Sub-Contract Provisions expressly provide that any conditional payment provision (such as “pay when paid”) included elsewhere in the sub-contract will be unenforceable and of no effect. This provision is not reflected in the SOP Provisions, presumably on the basis that the Hong Kong Government can ensure that no such provisions are included in the main contract.

In addition, the Mandatory Sub-Contract Provisions entitle sub-contractors of any tier to require the employer to make direct payment of any amount which has been adjudicated as due from the main contractor (or a higher-tier sub-contractor, as relevant) but which remains unpaid. The mechanism is complex, but in summary, requires the sub-contractor to make a written declaration that all or part of the adjudicated amount is due and remains unpaid, while the main contractor is given an

opportunity to provide documentary proof showing the contrary. Where a direct payment is made, the employer will be entitled to make a corresponding deduction from amounts due from the employer to the main contractor. Importantly, if the main contractor can demonstrate the sub-contractor was not paid due to the insolvency of a higher-tier sub-contractor, the employer will not make a direct payment.

Main contractors should be alert to the potential impact of the direct payment provisions. To avoid liability to the employer, the main contractor needs to police all tiers of its sub-contracting chain and ensure that payments are made as and when due.

The SOP Provisions impose an express obligation on main contractors to take all reasonable steps to ensure that the Mandatory Subcontract Conditions are included in all lower tiers of sub-contracts. Main contractors' compliance with this requirement will be monitored and failures to comply may result in a downgrade of that contractor's performance rating - likely impacting upon that contractor's ability to win future public works contracts.

### **Adjudicator's Powers To Make Determinations On Time-Related Costs**

In our experience, different jurisdictions have approached the question of whether an adjudicator should have the power to make determinations on extensions of time ("EOT") and the related costs in different ways. The treatment of EOTs and time-related costs will be an

important element in any SOP regime implemented in Hong Kong. How has this been addressed in the draft Circular?

The Circular says that the majority of the industry stakeholders support a proposal by which the adjudicator would be entitled to make binding determinations as to time-related costs forming part of a payment dispute. In order to make that determination, the adjudicator would also be empowered to make non-binding determinations as to the extension of time due for relevant delays. Despite the adjudicator's EOT determination being non-binding, the claimant would still be entitled to interim relief from liquidated damages levied in respect of any period covered by an adjudicator's EOT determination.

### **Getting Ready**

The introduction of a SOP regime will be one of the most significant reforms to the Hong Kong construction industry in decades. Construction industry participants will need to get up to speed on the legal, logistical and financial implications of the SOP regime quickly and efficiently. Decisions on resourcing, claim management strategy and risk mitigation are only some of the important issues affecting a construction business which will need to be thoughtfully addressed. Relatedly, the implementation of SOP in Hong Kong will unavoidably have its teething problems. Uncertainties, ambiguities and unexpected issues will be commonplace and require careful management.

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- 7 Graphic created and provided by the authors.

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