Security of Payment and Adjudication in Hong Kong

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Agenda

- Objective of SOP legislation
- Scope of Proposed SOP Legislation
- Unenforceability of Pay when Paid Provisions
- Payment Terms
- Statutory Payment Claim System
- Statutory Adjudication Process
- Enforcement and review
Introduction

- In 2012, the HK Govt established a working group of 14 industry stakeholders to evaluate the options for SOP legislation in HK.
- On 1 June 2015, consultation paper was issued by the working group setting out key aspects of the proposed legislation.
- Interested parties are invited to give comments by 31 August 2015.
- Proposed legislation hybrid between UK SOP legislation and Australian SOP legislation.
Objective of SOP legislation

- To ensure timely cash flow for contractors and subcontractors by way of periodic payments
- An industry wide survey in 2011 reported that 45% of main contractors and 57% of subcontractors had serious delays in payments
- To introduce a fast track dispute resolution process to ensure problems are resolved quickly during a project
- Current culture in the construction industry is to leave contractual claims e.g. EOT and major claims until the final account
Scope of Proposed SOP Legislation

When does the Proposed SOP Legislation Apply?

- Apply to contracts related to construction activities carried out in Hong Kong regardless of:
  - the nationalities of the parties; or
  - the prescribed governing law
- Apply to all contracts for construction activities entered into by the HK Government
- Apply to private sector contracts for new building works where the original contract value is more than HK$5,000,000 (does not apply to refurbishments)
- If main contract subject to legislation, then it will apply to all lower tier subcontracts
Scope of Proposed SOP Legislation (cont)

- Apply to provision of professional services, and supply of materials or plant in relation to construction activities carried out in HK
- Apply to oral and partly oral contracts
- However, some debate whether only apply to written contracts as per Singaporean and Malaysian SOP legislation
Scope of Proposed SOP Legislation (cont)

When doesn't the Proposed SOP Legislation Apply?

- Employment contracts
- Insurance contracts
- Guarantee contracts
- Loan contracts
- Investment contracts
- Accounting services
- Financial services (other than cost control and QS type services)
- Legal services
- Public relations services
Protections provided by Proposed SOP Legislation

Prohibited Clauses

- "Pay when Paid" clauses and clauses of similar effect will be unenforceable under the proposed legislation
- Standard position taken in security of payment legislation in England and Australia

Payment Terms/Payment Intervals

- Parties are free to agree on payment intervals for progress payments provided that
  - No more than 60 days for interim payments; and
  - No more than 120 days for final payments
- Defaults to 60 and 120 days respectively
- Consistent with the legislation enacted in New South Wales, Western Australia and Singapore
Statutory payment claim procedure

- Progress claims could be made purely on contractual basis
- In addition or alternatively, payment can be claimed by the statutory payment claims under Proposed SOP Legislation
- Statutory payment claim procedure is intended to operate in parallel to contractual payment procedures
- Contractors will not be able to claim any more than they could under the Contract – eg conditions precedents to payment, requirements for provision of particulars apply
Who can issue Statutory Payment Claims?

- Both claimant and respondent are entitled to claim progress payments by way of statutory payment claims.

Contents of Statutory Payment Claims

- SOP Legislation will set out minimum criteria to be met in terms of the content of payments claims including:
  - Details of amount claimed
  - Relevant work carried out
  - Basis of calculation etc

- Query whether compliance with prescribed requirements determines jurisdiction of adjudicator.

- NSW, adjudicator found to lack jurisdiction when the requisite footer not included in a payment claim.
How to respond to a Statutory Payment Claim?

- Respondent must serve his payment response within 30 days of a payment claim.
- Respondent to identify:
  - Amount of payment claim accepted as due
  - Disputed amounts and grounds of dispute
  - Any amounts intended to be set off against amounts due and the basis of set off
Statutory payment claim procedure (cont)

Failure to respond to a Statutory Payment Claim

- If the respondent ignores a payment claim, then:
  - Will not automatically liable to pay the full amount of payment claim; but
  - Will not be able to raise any set off or counterclaims during an adjudication
- In other words, the respondent could only raise liability and quantum defences in subsequent adjudication
- But not able to raise set off or counterclaims
- Statutory payment claim procedure is essentially the start of the adjudication process and provides respondents with notice of a forthcoming adjudication – one means of avoiding ambushes of the respondent
Implied Payment Provisions

- If no payment provisions in a Contract, then following terms are implied:

  - Parties entitled to make payment claims at monthly intervals

  - Payment due calculated based on value of work provided and valuation based on any contract price or market rates prevailing at the time the contract was entered into

  - Respondent to serve payment response within 30 days

  - Payment Period will be 60 days for interim payments and 120 days for final payments
Statutory adjudication Procedure

Adjudication Process - Intention of the Proposed SOP Legislation

- Operates in parallel to other legal and contractual remedies
- The purpose of the adjudication process is to provide a provisional determination and on account payments to keep the cash flow moving in a project
- Even after determination, parties to a dispute are still entitled to proceed to mediation, arbitration or litigation for final resolution of the dispute
Statutory adjudication Procedure (cont')

Who can apply for adjudication?

- Both parties will be able to refer disputes to adjudications
- More liberal than NSW and Singaporean legislation where respondents cannot commence adjudications
What disputes could be adjudicated?

- Payment disputes
- Set off / deductions
- Extensions of Time
- No jurisdiction to determine:
  - Quantum meruit
  - Breach of contract damages claims
  - Proper Interpretation of the Contract
Adjudication Application

- Adjudication must be commenced within 28 days of:
  - non-payment of the amount admitted as due in a payment response;
  - rejection of all or part of a payment claim;
  - failure to serve a payment response; or
  - a time dispute arising

- Proposed legislation does not make clear when a time dispute arises = disputes concerning jurisdiction
Statutory adjudication Procedure (cont')

Adjudication Application

- Adjudications commenced by service of notice of adjudication

- must set out:
  - brief details of the parties
  - the nature of the dispute
  - the redress sought

- **Query** – whether adjudicator would lack jurisdiction if adjudication notice served out of time eg WA legislation

- The claiming party must serve submissions together with all supporting evidence relied upon on or before the appointment of the adjudicator

- Need to anticipate all arguments – may not get another chance
Statutory adjudication Procedure (cont')

Appointment of Adjudicator

- An adjudicator is then either:
  - appointed by agreement; or
  - by nomination by an agreed or default nominating body (i.e. HKIAC) within 5 working days
- Nominating body could be agreed by the parties under the Contract
Responding to Adjudication Applications

- Respondent must respond with his own submissions and supporting evidence within 20 working days
- Possibility of extensions by the adjudicator – contrast Australian legislation where no extensions possible
Statutory adjudication Procedure (cont')

Adjudication Procedure

- The adjudicator is required to reach and publish his decision within 20 working days

- Extendable by the adjudicator up to 55 working days

- Could extend more than 55 working days if the parties agree

- The adjudicator is entitled to resign if he considers that it is not possible to decide the dispute fairly in the time available
An adjudicator:

- Is not bound by rules of evidence
- Can conduct the adjudication in such manner as he thinks fit
- Require further submissions and evidence from either party
- Call meetings with the parties
- Inspect relevant matters
- Set deadlines
- Issue procedural directions

Provided adjudication is concluded within 55 working days from the date of appointment or any agreed extension

Consultation Document suggests that adjudicators should decide matters on documents only
Adjudication Procedure

- Adjudicators should take a fair and robust approach to arrive at their decision as soon as possible.
- Consultation Document suggested that adjudicators do not need to have formal hearings with sworn witnesses and cross examination by lawyers.
- Each party will bear its own costs – no need for adjudicator to determine cost liability.
- Adjudicator's fees and expenses can be awarded to one party or the other depending on the result.
Addressing Ambush

- The proposed legislation seeks to address ambush concerns by providing:
  - an adjudicator with discretion to extend the deadline for serving an adjudication response
  - an adjudicator may disregard any submissions or evidence not made in the notice of adjudication which should reasonably have been made earlier

- But claiming party will always have a strategic advantage as:
  - he could simply withhold making his payment claims; and
  - the paying party will still have to respond within the limited timescale of the adjudication
Adjudication Applications and Responses

Practical Tips

- Check all arguments, set off and counter-claims raised in payment response
- Could seek a direction from adjudicator to provide further submissions but discretionary
- Recycling of claims?
- Be brief and concise in submissions – try not to be overly technical
- Good contract administration will help preparation of submissions by:
  - Keeping daily site records of what work was done
  - Taking photographic evidence at relevant times
  - Obtaining statutory declarations on work and quality
  - Obtaining independent assessment of work likely to be disputed
Effect of Adjudication Decisions

- Adjudication decisions are binding on the parties even if arbitration or legal proceeding have been commenced.
- Payments made under adjudication decisions are on account/provisional – keep the cash flow going.
- Arbitrator or Court would in making award or judgment allow for any amount paid under an adjudication determination.
Suspension for Non-Payment

- The proposed legislation introduces a right for parties to:
  - suspend all or part of the works; or
  - reduce their rate of progress
  after giving written notice (2-10 days) in the event of non-payment of a sum determined in an adjudicator's decision or non-payment of an amount admitted as due in a payment response

- Contractor who suspends or slows down progress for non-payment will have rights to an EOT and to reasonable costs and expenses in respect of delay or disruption
Enforcement and Review (cont')

Enforcement of Adjudication Decisions

- Adjudicator's decision will be enforceable in the same way as judgments of the Court without set off or deduction
- This means no new set off or deduction against the decision

Review of Adjudication Decisions

- Responding parties only have a short period within which to lodge any challenge as to validity
- No ability to appeal or challenge the merits of adjudicator's decisions
- Could only challenge validity from the procedural perspective eg breach of natural justice, jurisdictional error
- Consultation paper – only in very clear cases will a challenge succeed on these grounds
Questions

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