

Hong Kong Bar Association

Security for Payment Legislation:

Potential Implications for the Courts and the Bar

Background

1. The Security for Payment Legislation (“SOPL”) Bill was given its first and second reading on 29 May 2024. It is expected to be enacted in the second half of 2024. It is envisaged that the SOPL regime will be implemented in three phases, starting, about 8 months after the Ordinance is gazetted, as follows:

<u>Phase</u>	<u>Scope of implementation</u>	<u>Possible implementation date</u>
1	Public contracts and their sub-contracts <ul style="list-style-type: none">• non-time related payment disputes• all time related payment disputes	Second half of 2025?
2	Private contracts and their sub-contracts <ul style="list-style-type: none">• non-time related payment disputes• time related payment disputes only if the parties agree on the time part.	Second half of 2026?
3	Private contracts and their sub-contracts <ul style="list-style-type: none">• time related payment disputes	On a date gazetted by the Secretary for Development

2. The objective of the SOPL Bill is to improve cash flow in the construction industry, and in particular to speed up the flow of cash down through the various tiers of contractors, sub-contractors, suppliers and consultants.
3. For an overview of the SOPL regime, please see Annex A to this paper. In summary, however, the SOPL regime will, inter alia:
 - (i) introduce mandatory statutory provisions with respect to progress payments for a wide range of construction contracts including sub-contracts, and contracts for the supply of goods and services;

- (ii) prohibit the use of conditional payment obligations including pay when / if paid clauses;
 - (iii) establish a statutory adjudication system for binding interim determinations of payment disputes with adjudication decisions being required within 55 days unless the parties have agreed otherwise;
 - (iv) require the Courts (expressly, the CFI) to deal rapidly with applications to enforce adjudication decisions as court judgements, and also applications to set aside adjudication decisions. For an overview of the enforcement regime, please see Annex B to this paper.
4. The SOPL Bill is a bespoke statutory scheme. It borrows from the experience of similar schemes in other common law jurisdictions. It is not, however, a carbon copy of these other schemes. Some features are also relatively novel¹.

Potential implications for the Bar and the Courts

5. The SOPL Bill introduces statutory adjudication as a binding and enforceable interim determination of payment disputes. It does not, however, regulate or address the final determination of payment or other disputes.
6. Importantly, and unlike the approach in some jurisdictions, the SOPL Bill does not prohibit litigation/arbitration prior to completion of the construction project or even prior to the publication of an adjudication decision. See §50 of the Bill.
7. Parties will continue to be free, as they are now, to refer their disputes (including payment disputes) for final determination to the Courts or to arbitration when they wish to do so subject to any contractually agreed restrictions².

¹ For example, the inclusion of a self-help remedy, permitting the payee of an unpaid adjudication decision a limited statutory right to suspend or delay work without risk.

² Many existing construction contracts, for example, include provisions preventing arbitration prior to completion of the Works save in limited circumstances.

8. It is too early to predict what effect the SOPL regime will have in Hong Kong on the use of litigation / arbitration for construction disputes³.
9. What is, however, clear is that SOPL will have a material impact on work for both the Hong Kong Bar and Judiciary at least in respect of interim payment disputes.
10. In light both of the draft SOPL Bill, and also the experience in other jurisdictions that have introduced similar legislation, it can reasonably be anticipated that:
 - (i) SOPL will give rise to new streams of work for both the Courts and the Bar;
 - (ii) parties are likely to more inclined to bring contested proceedings in the CFI in the early periods after SOPL implementation when there will undoubtedly be uncertainty surrounding the proper interpretation, application and effect of aspects of the SOPL regime and also of the statutory adjudication process;
 - (iii) in the short to medium term there may well therefore be (as there have been in other common law jurisdiction) a significant increase in court applications whilst a body of case law is built up as to matters such as:
 - a. the general interpretation, application and effect of the SOPL Ordinance;
 - b. whether SOPL applies to particular contracts or situations;
 - c. whether particular contracts are or are not SOPL compliant;
 - d. whether purported payment notices, responses etc. were SOPL compliant and/or valid;
 - e. the proper interpretation, application and effect of the grounds to set aside adjudication decisions;

³ The experience in some jurisdictions is that statutory adjudication has led to a decline in litigation / arbitration for the final determination of disputes. This may or may not be the result in Hong Kong given differences here in both the SOPL itself, and the nature and extent of sub-contracting chains.

- (iv) paying parties are likely to be attracted to bring applications to set aside an adjudication decision as this will be the only route for avoiding liability to pay the adjudicated sums, and such there may well be a plethora of applications testing what constitutes:
 - a. a material denial of natural justice in the context of a 55 day statutory adjudication process as opposed to in arbitration;
 - b. a lack of independence and/or lack of impartiality in adjudications where in a relatively small professional market place;
 - c. an excess of the adjudicator's jurisdiction.
- (v) some of the applications brought in the short to medium term are likely to require detailed argument in the CFI, and possibly the Court of Appeal, in order to develop a body of coherent and consistent law;
- (vi) directions will need to be developed to address the requirement in the SOPL Bill that the applicant to a setting aside application shall pay the adjudicated sum into Court pursuant to directions given by the CFI;
- (vii) there is likely to be public policy pressure for applications to set aside an adjudication decision to be determined expeditiously by the CFI (and the appellate courts) given that the objectives of the SOPL are prompt payment and to get cash flowing fast within the construction industry⁴;
- (viii) the courts may face a number of applications to enforce unpaid adjudication decisions, and these will need to be considered rapidly as the SOPL Bill requires the CFI to grant an enforcement order within 7 days unless there is a pending application to set aside or the decision is no longer binding.

Possible areas for further consideration

11. The implementation of the SOPL may well therefore give rise to issues for internal consideration by the Judiciary, such as how best to list SOPL matters in light of:

⁴ The requirement for the adjudicated sum to be paid into court provides security during an application to set aside but does not get cash flowing within the construction industry chain.

- the need to develop a body of specialist case law on an important and bespoke statutory scheme that is intended to cause important and material change in the entire construction industry;
 - the benefits of reducing inconsistent first instance judgements when developing this body of case law;
 - competing resource demands within the Judiciary; and
 - the express statutory requirement that, at least some, applications to the CFI will to be considered and determined very fast (see SOP Bill §49(4)(5)) and the apparent expectation that all applications will be determined expeditiously.
12. There may also, it is respectfully posited, be a policy question for consideration as to how quickly an application to set aside an adjudication decision (which may or may not succeed) needs to be determined given that the public policy objective of the 55 day adjudication process in the SOPL is to require prompt payment, and to accelerate cashflow, within the construction industry⁵.
13. The Bar would not wish in any way to trespass on the Judiciary's considerations. In case, however, it assists, it is understood that the approach in some other common jurisdictions facing the introduction of similar legislation has been to designate one or two first instance judges to hear all applications so as to assist (i) with a consistent body of case law being developed, and (ii) expeditious determination by judges who become familiar with the specialist SOPL regime.

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⁵ It is understood that the Technology and Construction Court in England & Wales developed a policy that an application to set aside an adjudication decision before the TCC should generally be determined within the same period of time given to adjudicators to determine the underlying adjudication. It was considered that the TCC should not be a cause of lengthy delay in payment of an adjudicated sum in the event that the application failed. Appeals to the Court of Appeal are also generally dealt with on an expedited basis.

Annex A: Over-view of the SOPL Regime

1. The key planks of the SOPL regime as set out in the Bill are:

- (i) a statutory right to progress payments if a person has carried out work or has supplied related goods and services under a construction contract;
- (ii) the outlawing the use of pay-when-paid clauses and other forms of conditional payment provisions in contracts;
- (iii) the creation of a statutory adjudication scheme for fast and binding interim determination of payment disputes;
- (iv) the creation of a statutory self-help remedy in the event of an unpaid adjudication decision, permitting the beneficiary to suspend or delay work, subject to compliance with notification requirements;
- (v) a dedicated CFI enforcement regime for unpaid adjudication decisions (with appeals to the Court of Appeal only with leave):
 - a. CFI required to grant an order to enforce unpaid adjudication decision as a judgement within 7 days of an application unless there is a pending application to set aside the decision or it has ceased to be binding;
 - b. CFI to determine applications to set adjudication decisions on limited grounds set out in the SOPL Bill.

2. The draft SOPL regime once fully implemented, will be of wide application as:

- (i) it applies where “construction work” takes place in Hong Kong save for certain limited exempted categories such as very low value contracts⁶, contracts where the consideration payable is calculated otherwise than by

⁶ Construction work contracts including goods and Services: below HK\$5 million. Contracts for supply of services & goods only below HK\$ 500,000.

reference to the value of work or goods or services, private contracts for works at an existing residential unit or the common parts of a building⁷;

- (ii) it has, on any view, a wide statutory definition of “construction work” and of “related goods and services”⁸
- (iii) it expressly applies not just to contractors and sub-contractors but also to suppliers and a wide variety of consultants⁹;
- (iv) it applies to public contracts, private contracts and to Government¹⁰
- (v) it cannot be contracted out of;
- (vi) it applies even if a contract is not governed by Hong Kong law¹¹
- (vii) it may be open to argument that it applies extra-territorially in some cases.

3. It is envisaged that the SOPL regime will be implemented in three phases:

Phase	<u>Scope of implementation</u>	<u>Possible implementation date</u>
1	Public contracts and their sub-contracts <ul style="list-style-type: none"> • non-time related payment disputes • all time related payment disputes 	Second half of 2025?
2	Private contracts and their sub-contracts <ul style="list-style-type: none"> • non-time related payment disputes • time related payment disputes only if the parties agree on the time part. 	Second half of 2026?

⁷ See, inter alia, Bill §§ 8, 9, Schedule 4.

⁸ See, inter alia, Bill §§ 3, 6, Schedule 2.

⁹ See, inter alia, Bill §§ 5, 6.

¹⁰ See, inter alia, Bill §§ 7, 8, 10, Schedule 3.

¹¹ See, inter alia, Bill §§ 7(2) and 8(2).

3	Private contracts and their sub-contracts <ul style="list-style-type: none"> • time related payment disputes 	On a date gazetted by the Secretary for Development
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Annex B: Over-view of the Adjudication Enforcement Regime

1. Once a statutory adjudication has been commenced, the adjudicator must (unless the parties agree a longer to time) send the adjudication determination to the Nominating Body that nominated him/her within 55 days of the adjudicator's appointment¹².

2. The Nominating Body then serves the adjudication determination to the Parties. The date of this publication starts two different time limits running:

(i) It starts the time running for the payment deadline of the adjudicated sums:

The Payment Deadline is 30 days from the date of service unless otherwise stated in the Adjudication determination¹³.

(ii) It also starts time running for issuing any application to the CFI for an order setting aside the adjudication determination¹⁴:

An application to set aside must be issued within 14 days of the date of service of the Adjudication determination.

The application must be accompanied by an affidavit stating the grounds of the application¹⁵, and exhibiting the determination together with the relevant construction contract.

¹² See §42(5) of the SOPL Bill

¹³ See §43 of the SOPL Bill

¹⁴ See §§ 47 and 48 of the SOPL Bill.

¹⁵ §48(1) of the SOPL provides for four grounds of setting aside: (a) determination improperly procured by fraud or bribery, (b) a material denial of natural justice in the proceedings, (c) adjudicator has not acted independently or impartially in the proceedings, (d) adjudicator has acted in excess of the adjudicator's jurisdiction in the proceedings.

The applicant must pay into CFA as security the unpaid portion of the adjudicated sum in the way directed by the CFI, pending the final determination of the application.

Leave of the CFI is required for any appeal from a decision to grant or refuse a set aside application.

3. The statutory default position under the SOPL regime is therefore that the time limit for an application to set aside expires prior to the payment deadline for payment of the adjudicated sum. There is, however, no time period specified within which the CFI must determine the set aside application.
4. The draft SOPL provides two remedies if a party has not been paid the adjudicated sum in full by the payment deadline:
 - (i) It may give notice (of at least 5 working days) to the paying party and to the owner of its intention to suspend or delay work and, if still unpaid after expiry of that notice, may suspend or delay work at the risk of, and cost to, the paying party.
 - (ii) It may, if there is no application to set aside pending, issue an application to the CFI for leave to enforce the adjudication determination as a judgment¹⁶.

The application must be accompanied by an affidavit stating that the adjudicated amount has not been paid, and exhibiting the adjudication determination together with the relevant construction contract.

The CFI is required to grant leave within 7 days of the application unless:

- (a) a set aside application is pending; or
- (b) the CFI is satisfied that either (i) the determination is no longer binding on the parties or (ii) the adjudicated sum has been paid in full

If leave is granted, the CFI may enter judgment in terms of the adjudication determination.

¹⁶ See §49 of the draft SOPL Bill.

Leave of the CFI is required for any appeal from a decision to grant or refuse a set aside application.