

Security of Payment Provisions in Public Works Contracts

The Challenges Facing Hong Kong



Given the missed opportunity to address the fundamental issues at the core of Hong Kong's problems, the primary concepts of NEC are, in reality, still largely alien to the existing mentality of Contract procurement, risk allocation and final account resolution that pervades the industry. The deeply enshrined mindset of "Final Account negotiations" has no place in a properly administered NEC Contract genuinely administered under a spirit of co-operation, mutual trust and collaborative risk management between the contracting parties.

Article by Mike Ellis, Director of InSite Solutions Limited
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INTRODUCTION

It was in 1973 in the case of *Modern Engineering (Bristol) Ltd v Gilbert-Ash (Northern) Ltd* that the prominent UK judge, Lord Denning, famously said: “*There must be ‘cashflow’ in the building trade. It is the very life blood of the enterprise*”.

To help facilitate this flow of blood throughout the construction industry, many jurisdictions have introduced security of payment legislation to ensure regular and timely payments between the parties to a construction contract. A key component of such legislation is the right of any party, at any level of the procurement process, to refer a payment dispute to adjudication at any time.

Despite conducting many surveys extending over the past two decades, all of which revealed significant payment problems being experienced by main contractors, sub-contractors, consultants, sub-consultants and suppliers, the Hong Kong Government has still not introduced Security of Payment Legislation (‘SOPL’) to improve payment practices and provide speedy resolution of payment disputes.

However, there are now encouraging signs as the Government takes steps to address these problems, not as SOPL but rather, initially, as Security of Payment Provisions (‘SOPP’), which provide a contractual rather than statutory approach to the problem.

This article seeks to shed light on the challenges facing Hong Kong in the initial introduction of SOPP, which is intended to pave the way for more robust and far-reaching measures to be introduced later in the form of SOPL. The topics considered are:

1. Adjudication – what is it? (page 3 – 4)
2. Adjudication in Hong Kong (page 5)
3. Mandatory Adjudication and Security of Payment Legislation (SOPL) (background history) (page 6 – 8)
4. NEC4 Engineering and Construction Contract – Key Provisions: Payment, Compensation Events, Adjudication (page 9 – 10)
5. NEC Contracts in Hong Kong (page 11 – 14)
6. Security of Payment Provisions (SOPP) in Public Works Contracts in Hong Kong (page 15 – 25)
7. Challenges facing Hong Kong in the implementation of Mandatory Adjudication and SOPP (emphasis on NEC Contract) (page 26 – 41)
8. The Future – what about non-Public Works Contracts undertaken under NEC or other Contracts. What are the challenges of converting SOPP into SOPL (page 42 – 46)
9. Conclusion – the elephant in the room (page 47 – 48)

Within this narrative, reference is made to the following publications:

- Technical Circular: Development Bureau Technical Circular (Works) No.6/2021, Security of Payment Provisions in Public Works Contracts, dated 5 October 2021, including Annexes A – H thereto;
- Practice Notes: Development Bureau Practice Notes for New Engineering Contract (NEC) – Engineering and Construction Contract (ECC) for Public Works Projects in Hong Kong, issued July 2022;
- SOP Provisions: Development Bureau Security of Payment (SOP) Provisions for Public Works Contracts Using NEC4 ECC (Options A to D), issued August 2022;
- Standard NEC Amendments: Development Bureau Library of Standard Amendments to NEC ECC Standard Documents, issued September 2022;
- Standard NEC Additions: Development Bureau Library of Standard Additional Conditions of Contract, issued September 2022;
- UK Adjudication Report: "2022 Construction Adjudication in the United Kingdom: Tracing Trends and Guiding Reform", published by the Centre of Construction Law & Dispute Resolution, King's College London in collaboration with the Adjudication Society, published October 2022
- Government Press Release: Government Press Release LCQ19: Public Works Projects Adopting "New Engineering Contract" Form dated 23 November 2022, comprising a written reply by the Secretary for Development, Ms. Bernadette Linn, to a question raised by the Honourable Tony Tse in the Legislative Council that day

1: ADJUDICATION – WHAT IS IT?

A useful and succinct overview of Adjudication is provided by the Hong Kong International Arbitration Centre:

- *Adjudication is a simple, effective, and swift method of resolving disputes.*
- *Adjudications are conducted by a sole adjudicator in accordance with the Rules and terms of the contract and its applicable law.*
- *Adjudicators make decisions which are binding on the parties. In most cases, the decision of an adjudicator can be revised in another forum such as arbitration. Adjudication is common in construction disputes.*

Adjudication is the preferred dispute resolution procedure for use in conjunction with SOPL. Key components of Adjudication in this respect are:

1. A statutory procedure by which any party to a construction contract has the right to have a dispute decided by an Adjudicator;
2. It is intended to be quicker and more cost effective than litigation or arbitration;
3. It is normally used to obtain payment, although most types of dispute can be adjudicated;
4. The Adjudicator must decide the dispute in a prescribed number of days;
5. The Adjudicator's Award is binding in the first instance but may be challenged in Court;
6. Given the statutory nature of Adjudication, the Award will generally be upheld by the Courts unless there are serious jurisdictional issues or the position of one party has been prejudiced by a serious breach of natural justice.

Adjudication has been used to resolve disputes arising under SOPL for over two decades and is generally regarded as being a success. Whilst often referred to as being a "quick and dirty" method of dispute resolution, it is undeniably effective in facilitating the flow of cash through the various levels of the construction process and, in the main, Adjudicator's decisions are accepted as final determinations by the parties.

In the opening session of the recent Society of Construction Law Hong Kong One Day International Conference held on 11 November 2022, Philip Boulding KC cited the following statement from the then Sir Peter Coulson in 2015:

"Adjudication has been described as a parallel universe in which decisions which everyone knows to be wrong are solemnly upheld by the courts, and where potentially important disputes are decided at a gallop, with no time for the adjudicator to think very hard about any one problem before the next one arises for his/her decision."

Notwithstanding this, the now Right Honourable Lord Justice Coulson, currently a judge of the Court of Appeal of England and Wales is a strong supporter of Adjudication as an appropriate method of resolving construction disputes. In this respect, the UK Adjudication Report cites the following statement from Lord Justice Coulson in the 2021 case of John Doyle Construction Ltd (In Liquidation) v Erith Contractors Ltd, emphasis added:

*"I rather cavil at the suggestion that construction adjudication is somehow 'just a part of ADR'. In my view, that damns it with faint praise. In reality, it is the only system of compulsory dispute resolution of which I am aware which requires a decision by a specialist professional within 28 days, backed up by a specialist court enforcement scheme which (subject to jurisdiction and natural justice issues only) provides a judgement within weeks thereafter. It is not an alternative to anything; **for most construction disputes, it is the only game in town.**"*

Moreover, in his Foreword to the same report, Lord Justice Coulson states:

"Although the general success of construction adjudication is regarded as an accepted fact, the basis for that view is largely anecdotal. This Report is, as far as I am aware, the first comprehensive survey of construction adjudication from the perspective of the users, designed to find out what users like about the process, and what they do not. It is both comprehensive and clear."

Finally, in his Foreword to the report, Professor Renato Nazzini, Director of the Centre of Construction Law & Dispute Resolution, states:

"This Report shows that adjudication is an effective dispute resolution method in its own right and that, overall, the UK has a robust and resilient infrastructure that serves the adjudication process well from the nomination of the adjudicator by ANBs to the enforcement of the decision by the Courts."

and

"On the other hand, the circumstance that 42% of questionnaire respondents replied that less than 5% of adjudicated cases proceed to litigation or arbitration and 25% said that they have never experienced adjudication disputes proceeding further bears witness to the effectiveness of the process and the perception that most decisions are, at least, reasonable outcomes that allow the parties to move forward."

Thus, given the opportunity to function in an unfettered manner, it is clear that Adjudication will provide effective resolutions to construction disputes in a prompt and cost-effective manner.

2: ADJUDICATION IN HONG KONG

Whilst Adjudication is a concept that exists in Hong Kong, and the SAR has its own set of Adjudication Rules published by the Hong Kong International Arbitration Centre (HKIAC), it is not widely used, particularly in the construction industry. Indeed, it is understood that there has only been one Public Works Adjudication on a construction case, which was undertaken on a voluntary basis.

In that instance, involving a dispute of less than HK\$10M, the Parties were subjected to a 2-3 day hearing, with both Parties represented by lawyers, Counsel, Witnesses of Fact, Technical Experts and Quantum Experts and examination of witnesses, as if it was a mini-arbitration. Suffice to say, the feedback on the process was less than favourable.

It is also important to note that, to date, due to its internal regulatory procedures, the HKSAR Government, as the Employer, cannot comply with the timetable for the usual form of ADR procedure, namely Mediation, stipulated in its existing Form of Contract.

The question that naturally arises is, will the same constraints apply to Disputes administered under mandatory Adjudication? Clearly, if the government cannot adhere to the prescribed timetable or changes the timetable to reflect its own pace of administration, Adjudication under SOPP will be no improvement to the situation that already exists.

For mandatory Adjudication to be meaningful, there needs to be a fundamental change in procedures and accountability within the relevant government departments. Do the current proposals reflect this? Unfortunately, the signs cannot be interpreted as being encouraging in this regard.

3: MANDATORY ADJUDICATION

Mandatory Adjudication in respect of payment disputes between contractors, sub-contractors and employers has been successfully introduced in many jurisdictions since the late 1990s. However, Hong Kong lags far behind the field in the implementation of this critical legislative framework:

Implemented

- **United Kingdom:** Housing Grants, Construction & Regeneration Act 1996 (Following the Latham Report, July 1994);
- **Australia:**
 - New South Wales: Building & Construction Industry Security of Payment Act 1999;
 - Victoria: Building & Construction Industry Security of Payment Act 2002;
 - Queensland: Building & Construction Industry Payment Act 2004;
 - Western Australia: Construction Contracts Act 2004;
 - Northern Territory: Construction Contracts (Security of Payments) Act 2004 (NT);
 - South Australia: Building & Construction Industry Security of Payment Act 2009 (SA);
 - Australian Capital Territory: Building & Construction Industry (Security of Payment) Act 2009 (ACT);
 - Tasmania: Building & Construction Industry Security of Payment Act 2009 (Tas);
- **New Zealand:** Construction Contracts Act 2002;
- **Singapore:**
 - Building and Construction Industry Security of Payment Act 2004;
 - Building and Construction Industry Security of Payment Act 2006
- **Malaysia:** Construction Industry Payment & Adjudication Act 2012;
- **Ireland:** Construction Contracts Act 2013;
- **Canada:** Federal Prompt Payment for Construction Work Act 2019;

Pending

- **Thailand:** A draft Bill, 'The Act on the Settlement of Disputes regarding Payment in Construction', similar to equivalent legislation currently in force in Singapore and Malaysia, is currently at the public hearing stage.

Still Thinking

- **Hong Kong:** (Key documents highlighted in bold):
 - 2000: The Construction Industry Review Committee (CIRC) established;
 - 2001: The Tang Report "Construct for Excellence" published by CIRC;
 - 2005: Survey by the Hong Kong Construction Association (HKCA);
 - 2009: Survey by the Construction Industry Council (CIC);
 - 2011: Industry-wide survey conducted by Development Bureau and Construction Industry Council;
 - 2012: Working Group formed by Development Bureau;
 - 2012: Report on Survey on Payment Practice in the Construction Industry (Development Bureau);
 - 2015 - June: Proposed Security of Payment Legislation for the Construction Industry - Consultation Document;

- 2015 – December: Task Force for Preparation of Legislative Proposals to the Construction Industry Security of Payment Ordinance established;
- 2016: Report on the Public Consultation on Proposed Security of Payment Legislation for the Construction Industry;
- 2020 – April: DevB Working Group established to revise the conditions of public works contracts to align with SOP Framework;
- 2021 – March: Reference booklet for the implementation of Security of Payment Provisions in Public Works Contracts and draft Technical Circular with draft Security of Payment provisions for Public Works Contracts;
- **2021 – October: Development Bureau Technical Circular (Works) No. 6/2021, Security of Payment Provisions in Public Works Contracts (for Contracts tendered after 31 December 2021)** [NB: Covers NEC3 not NEC4];
- 2021 – October: DevB Library of Standard General Conditions of Tender (NEC4) - Part;
- 2021 – October: DevB Library of Standard Special Conditions of Tender (NEC4) - Part;
- 2021 – October: DevB Library of Standard Notes to Tenderers (NEC4) - Part;
- 2021 – October: DevB Sample Templates of Other Tender and Contract Documents (NEC4) - Part;
- 2021 – November: DevB Library of Standard Special Conditions of Tender (NEC4) - Part;
- 2021 – November: DevB Library of Standard Notes to Tenderers (NEC4) - Part;
- 2022 – January: DevB Library of Standard Notes to Tenderers (NEC4) - Part;
- 2022 – February: DevB Sample Templates of Other Tender and Contract Documents (NEC4) - Part;
- 2022 – March: DevB Library of Standard Notes to Tenderers (NEC4) - Part;
- 2022 – June: DevB Library of Standard General Conditions of Tender (NEC4) - Part;
- 2022 – June: DevB Library of Standard Special Conditions of Tender (NEC4) - Part;
- 2022 – June: DevB Library of Standard Notes to Tenderers (NEC4) - Part;
- **2022 – July: Practice Notes for New Engineering Contract (NEC) – Engineering and Construction Contract (ECC) for Public Works Projects in Hong Kong, published by DevB;**
- **2022 – August: Security of Payment (SOP) Provisions for Public Works Contracts Using NEC4 ECC (Options A to D);**
- 2022 – August: DevB Library of Standard General Conditions of Tender (NEC4) - Part;
- 2022 – August: DevB Library of Standard Notes to Tenderers (NEC4) - Part;
- 2022 – August: DevB Sample Templates of Other Tender and Contract Documents (NEC4) -Part;
- 2022 – September: DevB Library of Standard General Conditions of Tender (NEC4) – Part;
- 2022 – September: DevB Library of Standard Special Conditions of Tender (NEC4) – Part;
- 2022 – September: DevB Library of Standard Notes to Tenderers (NEC4) – Part;
- 2022 – September: DevB Sample Templates of Other Tender and Contract Documents (NEC4) – Part (revised);

- **2022 – September: DevB Publications;**
 - **Library of Standard Amendments to NEC ECC Standard Documents;**
 - **Library of Standard Additional Conditions of Contract;**

More than 20 years after the Tang Report, Hong Kong is still skirting around the peripheries of implementing mandatory Adjudication and Security of Payment Legislation.

4: NEC4 ENGINEERING AND CONSTRUCTION CONTRACT

NEC is a division of Thomas Telford Ltd, which is a wholly owned subsidiary of the Institution of Civil Engineers (ICE), the owner and developer of the NEC contract. The NEC is a suite of standard contracts used around the world, designed to facilitate and encourage good management of risks and uncertainties, using clear and simple language.

NEC4 is one of the suite of NEC Contracts and has been in existence for many years:

- 1991: Consultative Edition
- 1993: First Edition
- 1995: Second Edition
- 2005: Third Edition
- 2013: Reprinted with amendments
- 2017: Fourth Edition
- 2019: Reprinted with amendments
- 2020: Reprinted with amendments

As noted in the Preface to the current edition, there were three key objectives in drafting NEC4:

- to provide greater stimulus to good management;
- to support new approaches to procurement, which improve contract management; and
- to inspire increased use of NEC in new markets and sectors.

Relevant Core Clauses for the purposes of this article are:

Clause 5 Payment, comprising:

- 50: Assessing the amount due
- 51: Payment
- 52: Defined Cost
- 53: Final assessment

Clause 6 Compensation Events, comprising:

- 60: Compensation events
- 61: Notifying compensation events
- 62: Quotations for compensation events
- 63: Assessing compensation events
- 64: The Project Manager's assessments
- 65: Proposed instructions
- 66: Implementing compensation events

There are three options for resolving and avoiding disputes, with Option W1 being most applicable to the use of Adjudication in Hong Kong:

Option W1: Used when Adjudication is the method of dispute resolution and the United Kingdom Housing Grants, Construction and Regeneration Act 1996 does not apply

W1.1: Resolving Disputes

W1.2: The Adjudicator

W1.2 (1) The Parties appoint the Adjudicator under the NEC Dispute Resolution Service Contract current at the starting date.

W1.2 (3) If the Adjudicator is not identified in the Contract Data or if the Adjudicator resigns or is unable to act, the Parties choose a new Adjudicator jointly. If the Parties have not chosen an Adjudicator, either Party may ask the Adjudicator Nominating Body to choose one.

W1.3: The Adjudication

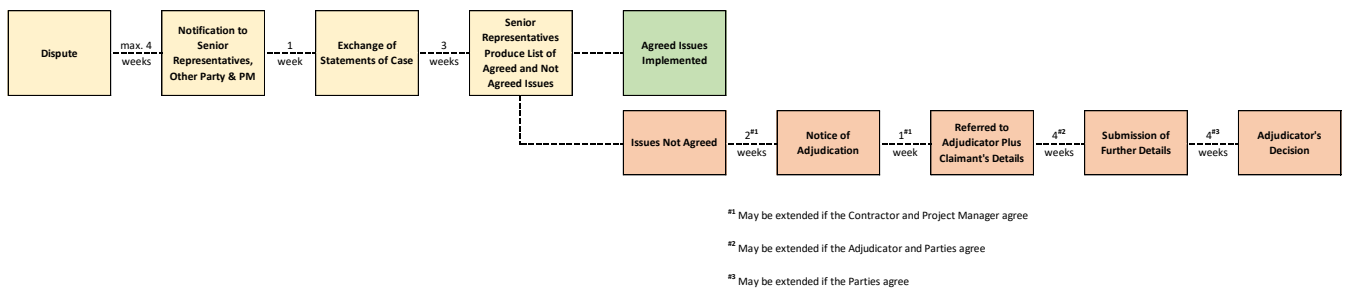
W1.4: The Tribunal

The Contract Data makes provision for the following in respect of resolving and avoiding disputes:

The Adjudicator is

The Adjudicator nominating body is

The timeframe for resolving a dispute under Option W1 is summarised below:



5: NEC CONTRACTS IN HONG KONG

In response to the 2001 Tang Report, the Government examined various forms of contract that embraced a partnering approach in the contractual relationship. The NEC contract has a proven track record of providing excellent project delivery in the procurement of major infrastructure and building projects in overseas countries and it was decided to pilot the use of the NEC3 ECC form.

The first NEC pilot project, the HK\$50M Improvement of Fuk Man Road Nullah in Sai Kung for DSD, commenced in 2009 and was completed in 2012, with satisfactory results being reported in terms of collaborative working and assurance in project time and cost.

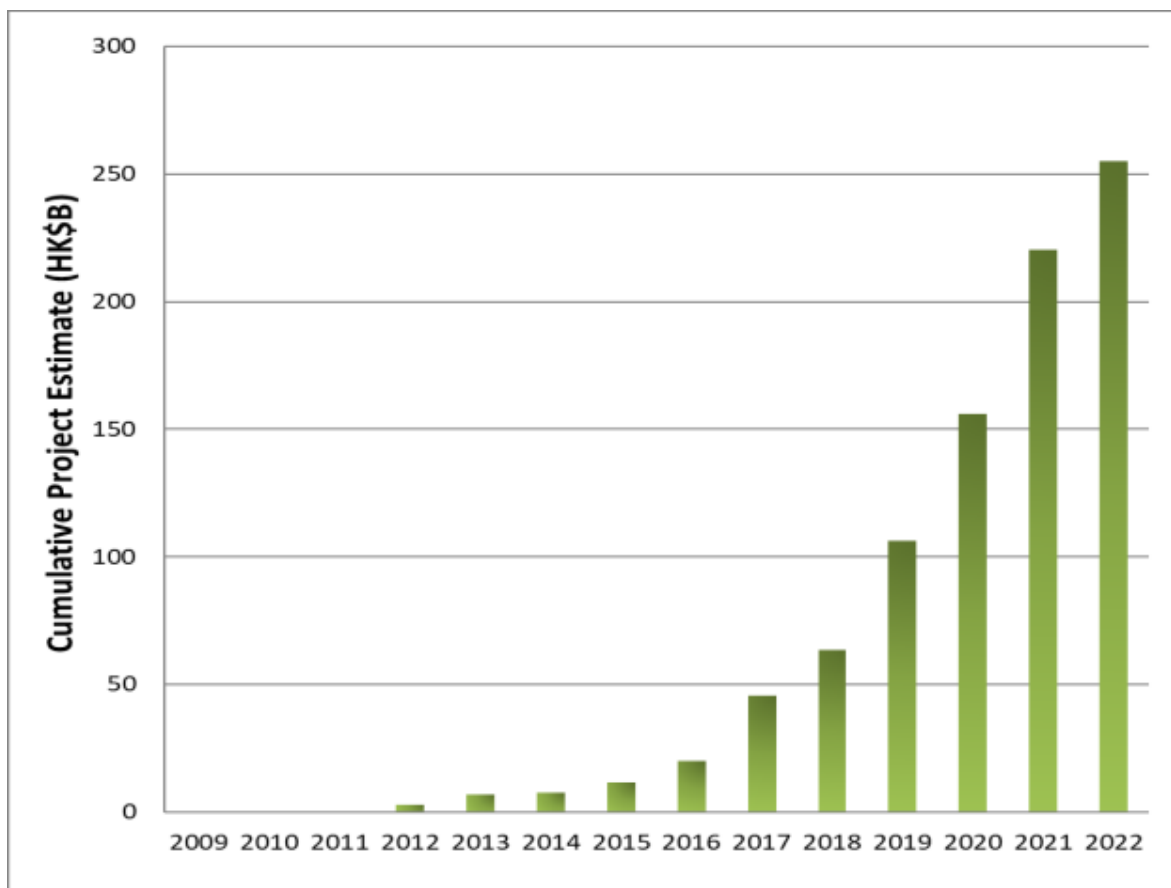
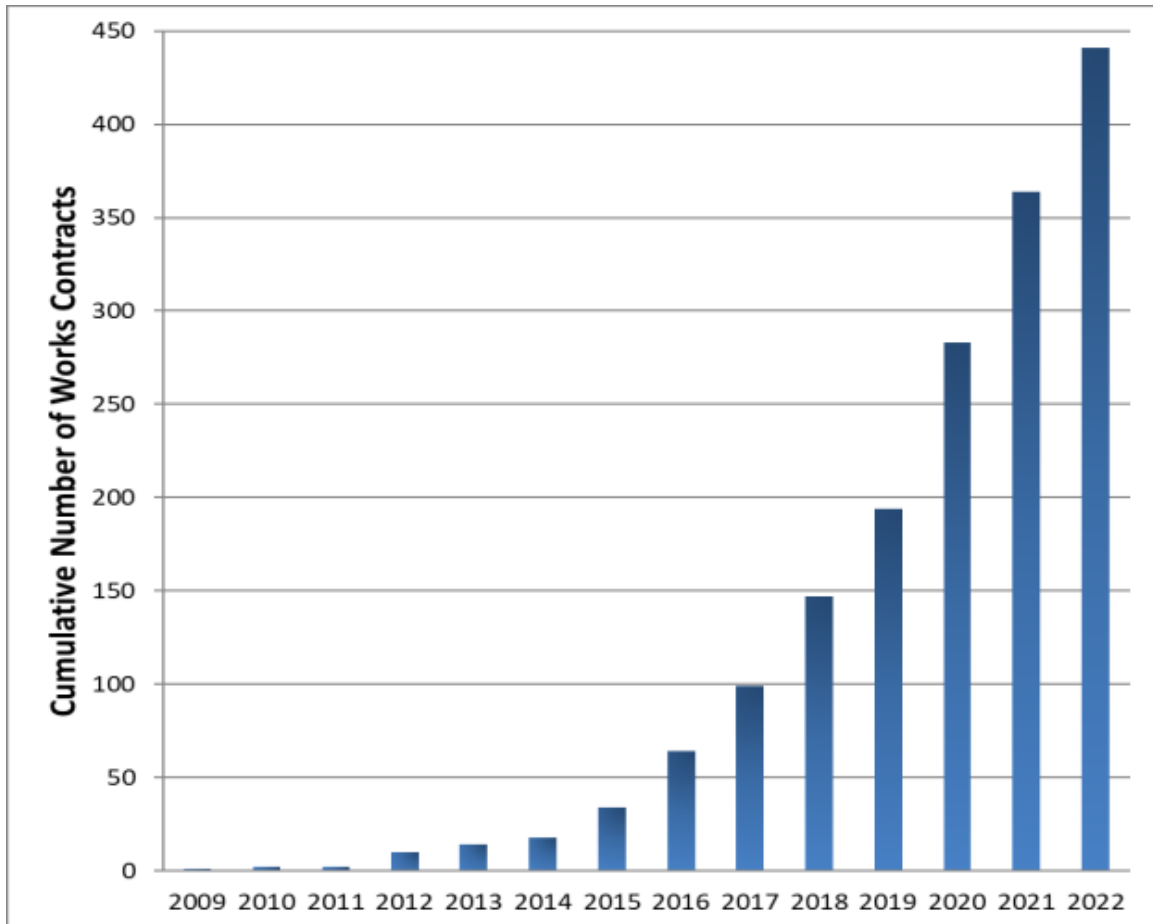
By early 2016, a number of public works projects had adopted the NEC form under the Government's Pilot Scheme Programme, using different Options and covering a wide range of works. Whilst the Contract usually included a comparatively high number of Z clauses the overarching NEC ethos was generally retained. The Government considers that it has achieved satisfactory results on these projects, which has led to its support for the continued use of the NEC form.

The Government has therefore extended the application of the NEC form in public works project procurement after 2016, in particular the adoption of Target Cost Options (Options C and D) in suitable mega-scale projects over HK\$1 billion such as tunnelling works, high speed roads, land formation works and the like.

Key milestones in the progressive implementation of public works projects procured under NEC include:

- 2009: Pilot Project. First NEC3 ECC – Fuk Man Road Nullah Improvement, Sai Kung
- 2012: Happy Valley Underground Stormwater Storage System, HK\$1B
- 2013: Tin Shui Wai Hospital – First NEC3 Building Contract
- 2017: Tung Chung New Town Extension – largest NEC3 ECC, HK\$17B
- 2018: First NEC4 ECC, Term Service Contract ('TSC') and Professional Service Contract ('PSC')
- 2022: Mandatory use of NEC4 for ECC and TSC

The growing influence of NEC as the standard form for procuring public works projects can be seen by the following government charts, presented at the NEC Asia-Pacific Conference in November 2022:



By reference to the current Government Tender Lists, it can be seen that the use of the NEC form has been expanded to include most of the Options and to cover projects below HK\$100 million.

The Government Press Release provided answers to the following questions:

1. The number of projects adopting NEC and its percentage of the total number of public works projects; the comparative original and actual cost expenditure of each completed project; and the cost estimate of each ongoing project.

Response to Question 1:

- i. Since 2013, DevB has been extending the application of the NEC in a progressive manner;
 - ii. In 2017, DevB issued guidelines requiring all large-scale public works contracts (over HK\$400 million) to adopt the NEC form;
 - iii. Since 2009, there have been over 400 public works contracts adopting NEC, with a total value of over HK\$250 billion (of which, 80 contracts have had their accounts finalised);
 - iv. The ratio of NEC contracts to all public works contracts has increased from 22% in 2017 to 47% in 2022. Over 90% of large-scale public works projects commenced in 2022 have adopted the NEC form;
 - v. The forecasted expenditure and actual expenditure of completed NEC contracts and the forecasted expenditure for each ongoing contract, for the past three years, was provided in the Annex to the reply
2. The management efficiency and cost effectiveness of the projects.

Response to Question 2:

- i. Based on the feedback received from various stakeholders, the NEC form is considered to have the following advantages over the conventional contract form:
 - Enhancing risk management through the introduction of the early warning mechanism. This encourages both the contractor and the client's representative to raise potential risks as early as possible and to negotiate and formulate the optimal solution when construction problems are encountered;
 - Optimising claim management through the use of the compensation event procedure, which expressly prescribes the timeframes for handling compensation events, enabling them to be properly dealt with in a timely manner during the course of the contract. It was reported that there was a time saving of over 30% on average in finalising NEC contracts as compared with conventional contracts;
 - Enhancing cost effectiveness through the "Target Contract" option, which incentivises the client's representative and the contractor to work in collaboration to formulate the optimal construction method;
 - Under the NEC's collaborative partnering principle, the project team works together proactively to resolve construction problems and difficulties in a timely manner, thereby reducing the risk of time and cost overrun.
3. The types of public works projects suitable for adopting the NEC form.

Response to Question 3:

- i. The NEC form is considered to be suitable for the majority of public works contracts.

Overall, therefore, the press release can be interpreted as a glowing endorsement of the use of NEC in the procurement of public works projects.

Whilst the Government's experience is founded primarily on NEC3, its future strategy is promulgated on the basis of using NEC4. This is reflected in the following comment appearing both on the first page and the rear cover of the current NEC4 contract:

The Development Bureau, HKSAR Government

The Development Bureau recommends the progressive transition from NEC3 to NEC4 in public works projects in Hong Kong. With suitable amendments to adapt to the Hong Kong local environment, NEC4 is expected to further enhance collaborative partnering, unlock innovations and achieve better cost management and value for money in public works projects.

In this respect, plans are already underway for the launch of a new DevB NEC suite of contract booklets, with the *ECC for Public Work Contracts, Hong Kong Development Bureau Edition* targeted for release in July 2023.

It is important to note that it is not just the Hong Kong Government that has an interest in adopting NEC contracts:

1. The first private NEC3 project was in 2012: HK Academy School;
2. The first MTRC NEC3 project was in 2014: Kennedy Town Swimming Pool;
3. MTRC is committed to using NEC4 on its future roll-out programme, having successfully used its version of NEC on the following projects:
 - Tseung Kwan O Line;
 - West Island Line;
 - Kwun Tong Line Extension;
 - South Island Line (East)
 - Express Rail Link;
 - Shatin to Central Link.
4. The first Airport Authority NEC4 project was in 2019, the Third Runway, and the Authority has recently successfully completed the construction of the new Airport Authority Office Tower using NEC4 Option C (Target Cost).

Thus, whilst the successful implementation of the core NEC principles under SOPP on Public Works is the immediate goal, it is even more important that a wide spectrum of practical experience is gained in order to provide meaningful feedback prior to the introduction of SOPL, which will cover the full range of construction projects.

6: SECURITY OF PAYMENT PROVISIONS IN PUBLIC WORKS CONTRACTS

Introduction

Despite the positive commitments given in the April 2016 Report on the 2015 Public Consultation on Proposed Security of Payment Legislation for the Construction Industry, the SOP Bill has still to be put before the Legislative Council for consideration. Instead, in mid-March 2021, the government issued a further set of consultation documents in the form of:

1. a reference booklet for the implementation of Security of Payment (SOP) Provisions in different tiers of sub-contracts under public works contracts; and
2. a draft Technical Circular with annexes covering draft Security of Payment provisions for inclusion in public works contracts and sub-contracts.

This was followed by the issuance of the Technical Circular in October 2021. This circular set out the government's policy on the implementation of Security of Payment Provisions (SOPP) in public works contracts with a view to:

1. facilitating the timely processing of contractual payments; and
2. providing an interim mechanism for the speedy resolution of payment disputes before the enactment of the proposed Security of Payment Legislation (SOPL).

Thus, whereas SOPL aims at assisting main contractors, sub-contractors, consultants, sub-consultants and suppliers to receive timely payments across all facets of the construction industry, as reflected in the 2015 consultation document, the current circular focuses only on implementing certain SOP requirements on public works contracts, term contracts and their related sub-contracts, tendered after the 'effective dates' of:

1. 31 December 2021 for Group B (up to HK\$400M) and Group C (over HK\$400M) Contractors; and
2. 1 April 2022 for other Contractors, Approved Suppliers of Materials or Specialist Contractors.

As such, it does not include contracts issued by statutory/public bodies or corporations, nor does it include private sector contracts. Additionally, the introduction of the limited provisions is on a contractual basis rather than on a statutory basis.

It is not clear when there will be legislation to reinforce the initial contractual obligations. As noted in the Technical Circular, DevB has formulated a SOP Framework and scope of application for drafting the proposed SOP Bill. The SOP Framework is included at Annex A to the Technical Circular and states:

'... in parallel with drafting of the SOP Bill, the spirit of the SOPL will be implemented in all new public works contracts first with a view to demonstrating the application of SOP provisions in contracts and enabling refinement of the SOP Bill based on practical experience gained to facilitate smooth introduction of the SOPL.'

However, there is no definitive statement as to when such legislation will be introduced, nor the full extent to which it will also apply to the private sector.

According to the latest advice from the Government, the 2023 Legislative Programme, which sets out the main pieces of legislation that the Government plans to introduce, has included provision for the Construction Industry Security of Payment Bill to be introduced into the Legislative Council in the second half of the 2023 legislative session.

In this regard, it remains to be seen what practical experience and meaningful feedback from relevant industry stakeholders will be available in order to facilitate the smooth introduction of SOPL and, indeed, when the legislation will actually be introduced.

Proposed SOP Provisions

Paragraph 7 of the Technical Circular states that all public works, including design and build contracts and term contracts for which tender invitations are issued on or after the effective dates, shall implement the spirit of SOPL through incorporation of Additional Conditions of

Contract ('ACC') and Special Conditions of Contract ('SCC') into the tender documents. The ACC and SCC are contained at Annexes B to H of the Technical Circular:

- Annex B: SOP Provisions for Main Contracts:
 - Additional Conditions of Contract for Capital Works Contracts using NEC3 ECC (Options A to D);
 - Amendment to NEC Clauses for Capital Works Contracts using NEC3 ECC (Options A to D);
 - Special Conditions of Contract for Capital Works Contracts using GCC 1999 Edition;
 - Additional Conditions of Contract for Term Contracts using NEC3 TSC (Option A);
 - Amendment to NEC Clauses for Term Contracts using NEC3 TSC (Option A);
 - Special Conditions of Contract for Term Contracts using GCC for Term Contracts;
- Annex C: Security of Payment (SOP) Provisions for Public Works Contracts using NEC3 ECC (Options A to D), NEC3 TSC (Option A) or GCC 1999 Edition;
- Annex D: Mandatory Subcontract Conditions for Security of Payment, including Security of Payment (SOP) Provisions for Relevant Subcontracts under Contracts using NEC3 ECC (Options A to D), NEC3 TSC (Option A) or GCC 1999 Edition;
- Annex E: Dispute Resolution Clause for:
 - Capital Works Contracts using NEC3 ECC (Options A to D);
 - Capital Works Contracts using GCC 1999 Edition (except GCC for D&B Contracts);
 - Capital Works Contracts using GCC for D&B Contracts 1999 Edition;
 - Term Contracts using NEC3 TSC (Option A);
 - Term Contracts using GCC for Term Contracts.
- Annex F: Guidelines on Scope and Contents of Subcontractor Management Plan and Guidelines on Documentary Proof to Demonstrate the Compliance of the Provisions in the SMP for:
 - Capital Works Contracts using NEC3 ECC;
 - Capital Works Contracts using GCC 1999 Edition/Term Contracts using GCC for Term Contracts;
 - Term Contracts using NEC3 TSC.
- Annex G: Sample Letter to the Main Contractor regarding Subcontractor's Request for Direct Payment of Outstanding Adjudicated Amount under a Relevant Subcontract;
- Annex H: Site Notice of Implementation of SOP Provisions in Relevant Subcontracts under the Main Contract.

The Technical Circular sets out four mandatory requirements under the SOP Framework, which cannot be excluded from the contract:

1. A payment response by the paying party shall be served on the claiming party within 30 days, and the paying party shall make payment of the admitted amount within 60 days to the claiming party from the date of payment claim served by the claiming party;
2. Conditional payment provisions, such as 'pay when paid' clauses and the like, shall be rendered ineffective and unenforceable;

3. The claimant may refer a payment dispute to Adjudication, through which the Adjudicator shall make a decision within 55 working days from the date of his appointment, and the adjudicated amount shall be paid as decided by the Adjudicator;
4. The claiming party/claimant may exercise its right to suspend or reduce the rate of progress if the admitted amount/adjudicated amount is not received.

In respect of the claiming party's right to refer any payment dispute to Adjudication, the SOP Provisions reflect the widely supported views from industry stakeholders that:

1. An Adjudicator shall have the power and jurisdiction to decide the time-related costs forming part of a payment dispute;
2. In deciding the amount of time-related costs, the Adjudicator shall have the power and jurisdiction to decide a party's entitlement to EOT;
3. The Adjudicator's decision on the time-related costs forming part of the payment dispute is binding and enforceable on an interim basis, but the EOT decided by the Adjudicator is not binding;
4. A party shall not be liable for delay damages if the works have been completed within the period of EOT decided by the Adjudicator.

Particular attention must be taken of paragraph 10 of the Technical Circular:

'Under the SOP Framework, contractual claim handling procedures as specified in contract should be gone through before any claims for additional payment can be submitted for determination by adjudicators. As such, the contract administrator's assessment on such claims, including any EOT claim associated with the payment dispute, should have been conducted and notified to the contracting parties before it would be referred to adjudication.'

This means that the contractual process for assessing claims must be completed before any further steps can be taken. This is an unusual feature of SOPP and careful compilation and review of payment claims will be required by the submitting party to ensure they do not fall foul of this requirement.

Paragraph 11 of the Technical Circular states:

'As the adjudicator's determination of the EOT claim may be different from the contract administrator's assessment, for practical implementation of the refined proposal in public works contracts, the EOT as determined by the adjudicator should prevail, hence the date for completion of the contract is taken as revised accordingly, in order to be consistent with the payment of the associated adjudicated amount as decided by the adjudicator. However, the parties' right for mediation or arbitration in respect of the payment dispute (and in connection with which any dispute on EOT) at the end of the contract remains unaffected.'

It should be noted that whilst the parties' right to challenge the award remains, this cannot happen until the end of the contract.

In terms of the appointment of the Adjudicator, this will be done through an agreed Adjudicator Nominating Body ('ANB') from the Administrative Register of ANBs as specified in the Contract. In this respect, paragraph 25 of the Technical Circular states:

'Adjudication provided under the SOP Framework is a speedy resolution of payment dispute. Appointment of adjudicator by an ANB as agreed by the contracting parties is intended to be done shortly after the service of the notice of adjudication. Whilst the SOP Framework allows for parties' post-contract agreement on ANB through claimant-proposed-respondent-selected procedure, this would however require making available several ANBs before the implementation and would have uncertainty on the readiness and willingness of potential organisations. Therefore, a simplified mechanism is introduced for the nomination and appointment of adjudicator through an agreed ANB from the DEVB's Register of ANBs as specified in the contracts, in order to ensure speedy commencement of the adjudication proceedings. This simplified mechanism is to be

adopted prior to further expansion of the DEVB’s Register of ANBs as well as mature development of the procedures of appointing adjudicator by the ANBs.’

Consequently, the parties will have no input into the choice of Adjudicator, unlike under a true NEC contract, and will, instead, have to settle for one chosen by a limited number of existing ANBs. This appears to be another missed opportunity since there has been ample time for the establishment of a body of suitably qualified ANBs. For example, the Hong Kong Institute of Construction Adjudicators was established in 2018 but is still to receive accreditation from the Government despite being registered in the private sector.

The current Register of Adjudicator Nominating Bodies comprises:

1. The Hong Kong Institute of Architects (HKIA);
2. The Hong Kong Institute of Surveyors (HKIS);
3. The Hong Kong Institution of Engineers (HKIE);
4. The Hong Kong International Arbitration Centre (HKIAC).

Whilst Annex A to the Technical Circular sets out the framework for the proposed Security of Payment Legislation for the Construction Industry, including the proposed procedures for Adjudication and Enforcement, paragraph 12 of the Technical Circular identifies parts of that framework that cannot be implemented through the current administrative approach via SOPP and which are therefore inapplicable under the current provisions:

Inapplicable Parts	Remarks
Apply to the Court for enforcement of an adjudication decision (Para. 20 in Annex A)	In order to prevent vain attempt of adjudication, this area is to be reconciled by Employer’s direct payment for settlement of unpaid adjudicated amount (vide paragraphs 17 to 20 below).
Apply to the Court for setting aside an adjudication decision (Para. 21 in Annex A)	Parties’ right to mediation or arbitration for final resolution of payment dispute is unaffected.
Statutory Register of Adjudicator Nominating Bodies (ANBs)	Selecting an ANB from DEVB’s Register and specifying it in contract would allow quickest nomination and appointment of adjudicator so as to smoothen the commencement of adjudication proceedings (vide paragraph 25 below).

In respect of the above, it should be noted that the current SOPP only address the lack of enforcement issue in respect of sub-contractors’ entitlements through the direct payment provisions. Whilst the Government will undoubtedly contend that it does not need to be forced to comply with an Adjudicator’s Award against it, there is still a void in this area, which will prevent feedback being obtained on this critical matter in advance of the introduction of SOPL.

In respect of any attempts at setting aside an Adjudicator’s Award through final resolution via Arbitration, this cannot be implemented until the end of the contract, which is no improvement on the current situation.

Subsequent to the issuance of the Technical Circular in October 2021, there have been a number of further documents issued by DevB, many with particular relevance to the NEC4 ECC Contract. Principle amongst these are:

- 2022 – July: Practice Notes for New Engineering Contract (NEC) – Engineering and Construction Contract (ECC) for Public Works Projects in Hong Kong, published by DevB (‘Practice Notes’);

Despite appearing to be a relatively contemporaneous document, Paragraph 2.2.1 of the Practice Notes identifies that it was first issued in October 2016 based on NEC3 and has been revised to provide guidance in the preparation and administration of public works projects using NEC4.

Given the scarcity of experience of using NEC4 contracts on public works projects, coupled with the various amendments arising from the SOP Provisions, it is hoped that the Practice Notes will be able to facilitate a proactive and pragmatic approach to the administration of the Contract. In this respect, Section A6 of the Practice Notes states:

A6.0 BUILDING UP A PARTNERING TEAM

A6.0.1 Under NEC, parties are required to work in mutual trust and collaborative manner. Good partnering spirit of the project team has to be built up gradually during construction through joint efforts in resolving site problems and developing ideas for the project. This is the most difficult yet an essential element for a project to succeed.

A6.0.2 At the commencement of contract, the Project Offices are encouraged to arrange with the Contractor a joint partnering workshop for establishing an effective communication channel, and setting up project common objectives. During the workshop, parties may also suggest some cost savings or innovative ideas to achieve the project objectives, making it another suitable occasion for adding value to the project, albeit other value management workshops may have been conducted in planning / design stage as per ETWB TCW No. 35/2002 (now subsumed under Section 1.4.2 of Chapter 1 of PAH).

A6.0.3 In order to monitor and maintain the partnering relationship throughout the course of contract, parties may also set up a "Champion Group", comprising members of management level of the project team, to regularly review the working relationship of their staff, and to propose improvement measures if any problem is identified.

Although these are undoubtedly encouraging words, practical experience in the past has shown that whilst Contractor's site offices are adorned with Partnering Charters and the like signed by all project participants, and the minutes of the early Partnering Workshops identify a commitment to adhere to the ethos of mutual trust and collaboration, these commitments soon disappear in the face of the inevitable challenges introduced by Hong Kong's "local environment".

Whilst comfort can be taken from the encouraging feedback obtained from both public and non-public works contracts procured under NEC, it remains to be seen if this will still be the case once the inevitable pressures generated by administering every public works contract under the SOP Provisions and timeframes are brought into play.

It is therefore essential that strong leadership is provided by both the Government and the Contractor to ensure that the NEC4 commitments reflected in the Practice Notes are implemented from the top down, particularly in respect of:

A6.1 Control of Time;

A6.2 Control of Cost;

A6.3 Compensation Events.

- 2022 – August: Security of Payment (SOP) Provisions for Public Works Contracts Using NEC4 ECC (Options A to D) ('SOP Provisions'):

Supersedes relevant parts of Annex C to the October 2021 Technical Circular.

- 2022 – September: DevB Publications:
 - Library of Standard Amendments to NEC ECC Standard Documents ('Standard NEC Amendments'):

A new document specific to NEC4 and SOPP.

- Library of Standard Additional Conditions of Contract ('Standard NEC Additions'):
 - A new document specific to NEC4 and SOPP.

From the Contractor's perspective, experience in other jurisdictions has shown that early identification of entitlements and obligations and the early implementation of procedures to facilitate such entitlements and obligations are essential in ensuring that maximum benefits are derived from SOP Provisions and Legislation.

In respect of Sub-Contractors, SOPP requirements are incorporated into all Sub-Contracts by virtue of Annex D to the Technical Circular: Mandatory Subcontract Conditions for Security of Payment, which is almost identical to the SOP Provisions under the main contract.

Particular notice should be taken of Clause SP-2 therein, which states, inter alia:

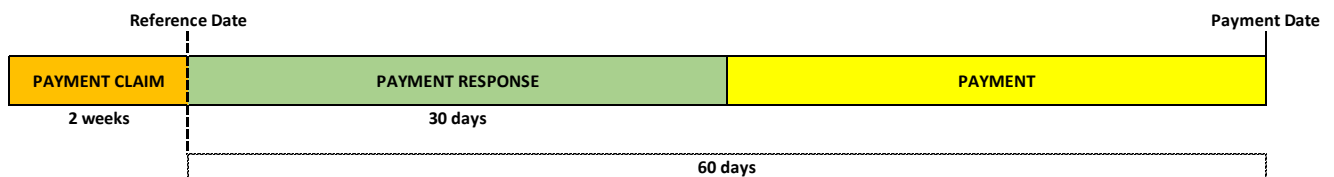
- (3) SOP Provisions for Relevant Sub-Contracts have effect despite any other provision in this Sub-contract
- (4) A provision of this Sub-Contract is void to the extent that –
 - a) it is inconsistent with the SOP Provisions for Relevant Sub-Contracts;
 - b) it has the effect of excluding, modifying or restricting the operation of the SOP Provisions for Relevant Sub-Contracts;
 - c) it may be construed as an attempt to deter a person from taking action under the SOP Provisions for Relevant Sub-Contracts.

The SOP Provisions for Sub-Contractor contain the same payment terms as those for the Main Contract so Contractors should make sure the relative assessment dates are suitably staggered to maintain cashflow.

As with the Main Contract requirements, a reference to Adjudication still requires compliance with the claim handling procedure but Sub-Contract Clause SOP 9 (3)-(4) is less prescriptive than the Main Contract equivalent and, given the contents of Clause SP-2 (3) and (4) noted above, is something that Contractors must pay particular attention to.

Payment Provisions

The most critical parts of the SOP Provisions are the payment provisions under Part 2, as amended by DevB's Library of Standard Amendments. These establish the Contractor's entitlement to receive progress payments and stipulate how these payments should be administered:



Reference Date and Payment Claim

A reference date is the date upon which a claimant is entitled to make a payment claim for a progress payment, pursuant to SOP Clause 2 (2). It should be noted that the NEC standard form refers to "assessment date" rather than "reference date" and it would appear to be advisable for the drafters to standardise these references to avoid any potential misunderstanding.

A claimant is entitled to submit a single payment claim for each reference date, which will generally arise at the end of the month, or at the end of a milestone period. The payment claim must be submitted to the Project Manager two weeks before each reference date [amended NEC Clause 50.2] and:

1. must be in writing;
2. must identify the construction work or related goods and services to which the payment claim relates;

3. must state the amount of the progress payment which is claimed to be payable -“claimed amount”;
4. must not include any amount that is the subject of an ongoing adjudication.

Unlike many other jurisdictions, there is no requirement for a payment claim to be specifically endorsed as such for the purpose of the SOP regime. Consequently, the receiving party, at all tiers, should treat every claim for payment as potentially falling under the SOPP and act on it accordingly – under no circumstances should they simply ignore it.

Payment claims under SOPP can also include contractual claims for payment for extensions of time.

Payment Response

After receiving a payment claim, the Project Manager certifies a payment in the form of a payment response within two weeks of each assessment date, but only if the payment claim was SOP compliant [Amended NEC Clause 51.1]. The payment response must:

1. be in writing;
2. identify the payment claim to which it relates;
3. state the amount admitted as due, before any set-off, and the basis of the calculation;
4. state the amount disputed as due, before any set-off, the grounds for the dispute and the basis of the calculation;
5. state the amount, the grounds for and the basis of the calculation of any amount to be set off or withheld; and
6. state the net amount to be paid and the calculation of the amount.

Whilst it is not obligatory for the respondent to issue a payment response, and if it doesn't it is regarded as disputing the claimed amount in full, it is recommended that a response is issued otherwise the respondent will not be able to raise any set-off in any subsequent adjudication in relation to the payment claim.

The Project Manager's certificate only constitutes a payment response if the initiating payment claim was SOP compliant and submitted two weeks before the assessment date. Otherwise, the certificate does not fall under the SOP Provisions, thus there cannot be a bona fide payment dispute under SOPP.

It should also be noted that whereas the Technical Circular states that it is a mandatory requirement that a payment response must be served within **30 days**, the amended NEC Clause 51.1 requires the payment response to be issued within **two weeks**.

Payment

The default payment period under NEC Clause 51.2 is 3 weeks unless stated different in the Contract Data. Since there are no amendments to this requirement in the Standard NEC Amendments, it must be assumed that the SOPP period of 60 days will be identified in the Contract Data.

It is also assumed that the 60-day period commences on the reference date, not the date of submission of the payment claim.

The Payment Dispute

A key feature of SOPP is the emergence of a payment dispute. Critically, the right of a party to refer a dispute to Adjudication hinges upon the existence of a payment dispute. Moreover, Adjudication is limited to payment disputes only, which may relate to base scope works or to claims for additional payment.

Claims for additional payment may include, inter alia:

- Increases in the Price;
- Increases in Allowable Costs;
- Additional payment arising from Extension of Time ('EOT') and the like.

Claims for non-compensable EOT are excluded, as are all other non-payment related items.

In this respect, under NEC a compensation event ('CE') is any event that can affect the cost to the Client, the time when the works will be completed, or both. A CE is the only way those components can be changed – there are no other ways for the Contractor to claim additional payment. The Contractor includes the value of CEs in its payment claims.

A payment dispute arises when a compliant payment claim has been submitted and:

1. the payment claim is disputed, either in whole or in part, through a payment response; or
2. set-off or withholding all or any part of the claimed amount is raised; or
3. the respondent has served a payment notice stating an admitted amount to be due, but has failed to make payment; or
4. the respondent has failed to serve a payment response by the due date (30 days, unless an earlier date is agreed) and fails to pay the claimed amount in full by the payable date.

Although this sounds straightforward, the position is complicated in that a payment dispute will not arise in relation to a payment claim until the "claim handling procedure" under the contract has been complied with. Broadly speaking, this means that the contractual process for assessing claims must be completed before any further steps can be taken under the ambit of a payment dispute. Arguments about whether and when the claim handling procedure has been complied with could present an obstacle for parties wanting to move forward with the Adjudication process. This is an unusual feature of the SOP Framework and one which needs to be considered carefully by any party seeking to initiate an Adjudication.

Adjudication

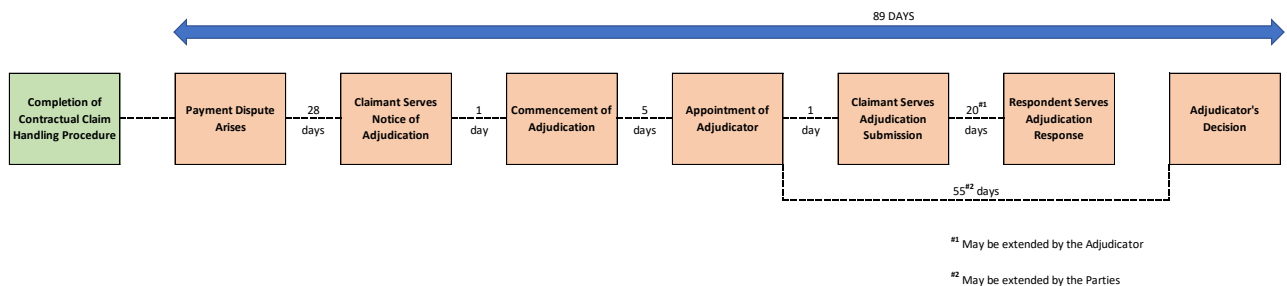
Assuming that a valid payment dispute has arisen, the Contractor may, within 28 days after the date on which the payment dispute arises, initiate an adjudication of the payment dispute under SOP Provisions Clause 11.

The Contractor (as Claimant) initiates the adjudication against the Client (as Respondent) by serving a notice of adjudication on the Respondent. A copy of the notice is also served to the PM on the same day.

A notice of adjudication must be in writing and state:

- the Claimant and the Respondent;
- the relevant payment claim and any payment response;
- the nature and description of the payment dispute; and
- the claimed amount and remedy sought.

The adjudication commences on the first working day after the date on which the notice of adjudication is served on the Respondent:



Under SOPP Provisions Clause 27, the Adjudicator's decision is binding on the Parties and enforceable as a contractual obligation unless and until the payment dispute:

- is settled by agreement in writing between the Parties; or

- is determined by arbitration or court proceedings.

The Adjudicator may correct errors in the decision within 5 working days after its issuance, either on his own initiative or by either party's request [SOPP Provisions Clause 28].

Pursuant to SOPP Provisions Clause 30, an adjudicated amount must be paid on or before:

- a) the date specified by the Adjudicator in the decision; or
- b) Within 30 days after the decision is issued if no date is specified by the Adjudicator.

Interest is payable on unpaid adjudicated amounts on a simple interest basis at the prescribed judgement debt rate [SOPP Provisions Clause 30A]

If payment is not made as per the Adjudicator's decision, the contractor or sub-contractor may delay the progress of works or suspend the work and any additional payment arising therefrom shall be borne by the Client/Contractor as appropriate.

In this respect, SOPP Provisions Clause 37 (3) provides that in the event of non-payment of an adjudicated amount, the Contractor may suspend or reduce the rate of progress of the works if:

- a) the Client has not paid the adjudicated amount to the Contractor in full by the payment deadline;
- b) the Contractor serves a compliant notice of intended suspension on the Client after the payment deadline and at least 5 working days before the date of intended suspension/reduction in progress.

SOPP Provisions Clause 37 (6) (c) states that the Contractor must resume progress of the works within 7 days of receiving the adjudicated amount in full.

Identical provisions to those above are also incorporated into all Sub-Contract Agreements under the Mandatory Subcontract Conditions for Security of Payment included at Annex D to the Technical Circular.

In addition, in the event of a non-paying contractor, the aggrieved sub-contractors may request for direct payment of an adjudicated amount from the Client. SOPP Provisions Clause 43 allows the Client to make direct payment of an unpaid Adjudicated Amount to a sub-contractor under any tier of the relevant sub-contract

However, this must be done with caution as the upper-tier contractor or sub-contractors may be subject to winding up proceedings which may expose the Employer to unauthorised payments on behalf of the appointed liquidators.

It is noted that NEC Clause 53.4 has been amended to state, emphasis added:

The assessment of the final amount due is changed to include

- *any agreement the Parties reach and*
- *A decision of the Adjudicator ~~or recommendation of the Dispute Avoidance Board~~ which has not been referred to the tribunal within four weeks of that decision or recommendation*

~~A changed assessment becomes conclusive evidence of the final amount due under or in connection with the contract~~

In this respect, the changed assessment would include the amount of compensation events either agreed between the parties or determined under an Adjudicator's decision, but it would appear that these are no longer considered to be conclusive.

The rationale given for the deletion of the final sentence is:

"To prevent the Government from being debarred from initiating legal action after assessment of the final amount due."

However, this situation would surely apply to the Contractor too, and an early clarification on this matter would be very helpful to NEC users.

SOPP in Public Works Contracts - Conclusion

Whilst it appears that the long-overdue safeguards derived from Security of Payment are finally in sight, what does this actually mean to the construction industry in Hong Kong, and to those on the contracting side in particular? Is it a panacea for the serious cashflow problems that exist or is it merely a 'Wild West miracle elixir' promising much but delivering little? Whatever, it appears inevitable that it will introduce a further administrative burden to be shouldered by the already beleaguered contractors.

One thing that is certain, is that the introduction of SOP Provisions will be one of the most significant reforms of the industry in decades, and all participants will need to both understand and implement the logistical, legal and financial requirements very quickly.

The Technical Circular highlights that the SOP principle is new to Hong Kong and that its provisions for Adjudication and enforcement are different from traditional contract dispute resolution arrangements. Indeed, this is the reason cited for implementing the spirit of SOP in all new public works contracts first, which will be pursued in tandem with the drafting of the SOP Bill. But is this the best approach overall?

Public works contracts and private contracts are inherently different in terms of size, complexity, risk mitigation and a host of other considerations. Is it logical to base the overall legislation on experience derived from just one element of the industry portfolio? Nevertheless, this is the direction in which Hong Kong is headed and all stakeholders need to address the implications accordingly.

From the practical point of view, the early introduction of the necessary internal processes to facilitate the new provisions are absolutely essential for any contracting organisation. Whilst it is relatively easy to determine the processes between Contractor and Client, these are considerably multiplied under the contractor/sub-contractor and sub-contractor/sub-sub-contractor relationships.

It is possible that Clients will demand far more detailed particularisation of progress payment applications for both initial contract scope and variation works/claims, fully complying with time and substantiation requirements stipulated within the Contract. Unsubstantiated lump sums for "on-account payment for Variations and Claims" could well become a thing of the past.

Critically, the Technical Circular states that the contractual claim handling procedures should be gone through before raising claims under SOP Provisions, so the contract administrator's assessment of EOT should have been conducted and notified before it could be referred to Adjudication. In this regard, public works contracts in Hong Kong are not prime examples of the issuance of contemporaneous EOT awards and other such decisions.

In addition, how will the Adjudications be run? Whilst the Adjudicator has certain flexibility in determining the precise conduct of the Adjudication, each party may be represented by whichever representatives it considers appropriate. Experience of the Adjudication process in Hong Kong is extremely limited and there is always the possibility that Adjudications will simply be turned into mini-arbitrations with the parties represented by Counsel, lawyers, experts and witnesses of fact, which completely defeats the purpose of SOPP.

Moreover, will the proposed Adjudication process actually deliver what the parties are seeking – expediency, clarity and finality?

- The parties have no say in the appointment of the Adjudicator;
- The parties cannot apply to the Court for enforcement of an Adjudicator's Award;
- The parties cannot apply to the Court for the setting-aside of an Adjudicator's Award;
- Any disputes on the Adjudicator's Award still need to be pursued through the contractual procedures of either mediation and/or arbitration.

Inevitably, in addition to the increased administrative burden, the implementation of SOPP in Hong Kong will have teething problems arising out of uncertainties, ambiguities and unforeseen issues. Critical matters for every tier of the process to consider include:

1. Early incorporation of the necessary internal company processes to ensure compliance with the mandatory payment provisions;

2. Early incorporation of the necessary standard amendments into contract documents;
3. Careful review of other contract amendments and Special Conditions of Contract to ensure there are no deviations to the process sneaked in through the back door;
4. Timely preparation and submission of fully detailed progress payment applications to ensure compliant payment claims;
5. Timely submission of compliant payment responses by the paying party;
6. Early correction of valid objections to progress payment applications to ensure subsequent applications are honoured;
7. Timely notification, preparation and submission of fully detailed claims for EOT;
8. Robust pursuit of EOT entitlements under the contractual mechanism;
9. Strict adherence to the timing and procedures related to any Adjudications that may be initiated, including the issuance of notices and particulars;
10. Careful consideration of implementing any entitlements to suspend or reduce the progress of works;
11. Proper administration of the pursuit/rejection of claims for direct payment from employers.

7: CHALLENGES FACING HONG KONG

Experience both in Hong Kong and globally has shown that successful outcomes from NEC Contracts are derived from an approach that is based on:

1. collaboration;
2. providing value for money;
3. adopting a non-adversarial but, at the same time, professional attitude;
4. embracing proactive management;
5. taking ownership and resolution of issues, not blame;
6. implementing prompt solutions to problems and disagreements.

These objectives are written into the NEC Contract and, if followed, will produce:

1. the lowest out-turn cost for the Client; and
2. a profitable outcome for the Contractor.

The overarching challenge facing Hong Kong is to overcome, at all levels, the entrenched mindsets within all stakeholders that are alien to the above approach. This can only be achieved if the Government provides the necessary procedures and resources for such a change to occur.

The problems that have plagued the industry for year are succinctly summarised in the Government Press Release:

'The conventional form of the contract previously adopted in public works, focusing more on the obligations and responsibilities of the two contracting parties, often put them in adversarial positions. Once problems of foreseeable risks occurred during the construction period, both parties tended to focus on identifying the responsible party, and hence more disputes arose in the process. As a result, the problem was not dealt with properly and it might take more time or even cost to complete the works, which was not conducive to the smooth implementation of the project.'

In this respect, it is important to acknowledge that both parties have been happy to adopt a 'wait and see' approach:

- The Government uses it as a way to grant largely full EOT entitlements for non-compensable events as a 'concession' to protect contractors against Liquidated Damages, ignoring the Government's culpable delays; and
- Contractors wait until their overall needs are identified and then pursue fully compensable EOT claims to generate additional revenue, focusing only on the Government's culpable delays.

Neither approach reflects the parties' true entitlements and liabilities arising from the manner in which the project has been constructed and administered and certainly do not follow the ethos of mutual trust and understanding.

In the Government Press Release, the Secretary for Development goes on to say:

'In contrast, the NEC embraces a collaborative culture and through contractual mechanisms fosters the building of a mutual assistance/trust partnering relationship between the contracting parties as well as joint risk management, thereby enhancing project management performance and cost-effectiveness.'

These words are an unequivocal endorsement of the benefits to be gained by adopting and embracing the full ethos behind the NEC form. But this is not what the Government intends to do.

As noted earlier, the current edition of the NEC4 contract contains the following comment, emphasis added:

The Development Bureau, HKSAR Government

*The Development Bureau recommends the progressive transition from NEC3 to NEC4 in public works projects in Hong Kong. **With suitable amendments to adapt to the Hong***

Kong local environment, NEC4 is expected to further enhance collaborative partnering, unlock innovations and achieve better cost management and value for money in public works projects.

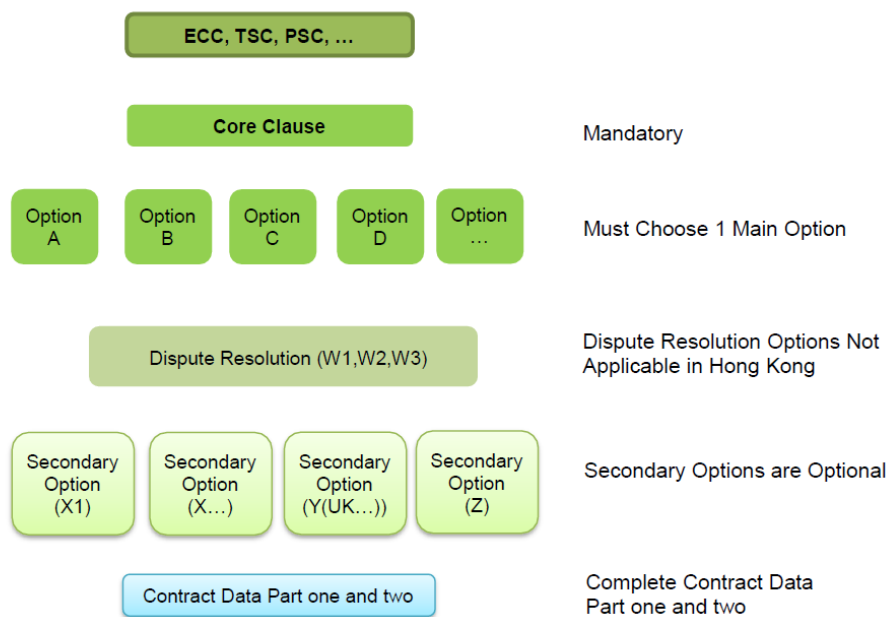
Despite the acknowledged success of the NEC form in delivering projects throughout the world, the Hong Kong Government considers it necessary to amend the standard form to “*adapt to the Hong Kong local environment*”. This appears to be a missed opportunity and, given the length of time that has been available to rectify the acknowledged industry-wide failings identified in the Tang Report, a better approach would surely have been to amend the Hong Kong local environment to be more in line with the collaborative ethos enshrined in the NEC Contract.

Given the missed opportunity to address the fundamental issues at the core of Hong Kong’s problems, the primary concepts of the NEC are, in reality, still largely alien to the existing mentality of Contract procurement, risk allocation and final account resolution that pervades the industry. The deeply enshrined mindset of “Final Account negotiations” has no place in a properly administered NEC Contract genuinely administered under a spirit of co-operation, mutual trust and collaborative risk management between the contracting parties. However, it will not simply disappear overnight by the introduction of heavily amended NEC Forms incorporating Security of Payment Provisions.

Elsewhere, all other jurisdictions have embraced Security of Payment Legislation and Mandatory Adjudication fully across the construction industry and considerably quicker than Hong Kong. Problems have been identified and evidence shows that both the industry and Adjudication Law can develop quickly to resolve issues that arise. Indeed, Adjudicators have benefited from guidance from the courts as to the extent of an Adjudicator’s jurisdiction and in relation to procedural matters, particularly during the early days of the implementation of a new SOP regime. Such guidance will not be available to the Hong Kong Adjudication profession, although court decisions from other relevant jurisdictions may be referred to for guidance.

Ultimately, however, Hong Kong lags considerably far behind other jurisdictions in terms of the resources, infrastructure and mindset necessary to effectively operate the critical components required to successfully administer the SOP process as envisaged under NEC.

Paragraph 3.1.3 of the July 2022 Practice Notes provides the following flowchart of NEC formation:



It remains questionable as to why Dispute Resolution Option W1, which provides for Adjudication as the prescribed process, should be considered to be not applicable in Hong Kong.

It is anticipated that the greatest challenge facing the Hong Kong construction industry will arise from the introduction of mandatory, but not statutory, Adjudications as the prescribed method for resolving payment disputes. In particular, it remains to be seen how the Government

responds to the timeframes imposed on it, most notably in respect of the specified contractual claim handling procedure, which is discussed in detail later herein.

Based on experiences elsewhere to date, it is inevitable that there will be challenges to the Adjudication process, most notably relating to jurisdictional matters including, inter alia:

1. Challenges that the Adjudicator has not been properly appointed;
2. Challenges that the Adjudicator does not have jurisdiction to determine a particular issue referred to him, either in part or at all.

Even if a party raises a jurisdictional challenge and the Adjudicator determines that he does have jurisdiction to proceed, which he has the power to do, the objecting party still has the right to challenge the Award on jurisdictional grounds. However, unlike in countries with mature SOP Provisions established in legislation, parties in Hong Kong cannot refer the Adjudicator's Award to the Courts for enforcement or setting-aside. Rather, they are constrained by the current requirements for referral to mediation or arbitration with a default timeframe of after the Completion of the Works. Any arbitral awards will be private and confidential and may be challenged only in limited circumstances.

It is hoped that the Parties to the Public Works Contracts will adhere to the principles of mutual trust and collaboration enshrined in the NEC contract, which will lead to the success of SOPP and an early introduction of suitably refined SOPL.

In this regard, it is inevitable that differences between the parties will arise, which will require resolution through an independent, third-party arbiter. SOPP provides for this through Adjudication and it is essential for the longer-term development of SOPL that Adjudication is seen to be effective in facilitating cashflow throughout the construction chain. For this to happen, it is essential that disputes are allowed to be referred to Adjudication and that Adjudicator's decisions need to be respected and complied with.

It is naïve to assume that there will be no challenges to Adjudicator's awards but these should be the exception rather than the norm. As in all other jurisdictions with mature SOPL in place, the paying party should comply with its obligations to allow cash to flow and the works to progress.

Only time will tell how effective Adjudication will be and it must remain a concern that the lack of statutory basis behind it may hamper its efficacy. Some potential challenges are considered below.

Service of the Claimant's submission is required within 1 working day after the Adjudicator's appointment. Could this lead to a de facto ambush or, more worryingly, a poorly prepared submission?

Since the Adjudication process is limited to payment disputes only, the Parties should be able to monitor the situation and anticipate the likely timing and nature of any submission, thus safeguarding against ambush. However, on the other hand, if the claiming party has been subject to stalling tactics on the part of the receiving party and has acceded to such action to avoid "upsetting" the receiving party, it may suddenly find itself at the end of the prescribed notice period, either for notifying a compensation event or for notifying a payment dispute, which could result in it having to submit a hastily prepared submission in order not to be time-barred.

There is no provision for the Claimant's reply to a Respondent's response. This is contrary to the usual dispute resolution protocols and may prejudice the Claimant (for example, if the Respondent introduces an Expert Report into its response).

Either or both parties may introduce Expert Reports into their submissions, but are these really appropriate? The Adjudication is to resolve matters that the Contractor and Project Manager are required to agree upon as part of their basic contractual obligations. Adjudication is limited to payment disputes only, not complex technical or legal issues, and it should be in the capability of the respective project teams to resolve them. Adjudication submissions should hopefully be on the same level of particularisation as the normal contractual submissions.

Paragraph 25 of the Technical Circular states:

“Adjudication provided under the SOP Framework is a speedy resolution of payment dispute.”

It is important to not lose sight of this goal. Adjudication is not a mini-arbitration and ideally there should be no Experts, no hearing, no witnesses, no cross-examination, and legal representation kept to a minimum. Adjudicators must be allowed to determine the appropriate procedure for the dispute put before them and must not be pressured into following a procedure favoured by the dominant party.

Key to many of the above concerns is SOP Provisions Clause 21, which appears to be a critical jurisdictional issue and may be summarised thus:

The Adjudicator must not take account of anything that:

- was not provided within the required timeframe;
- the other party was unaware of on the date of the adjudication notice;
- should reasonably have been served prior to the adjudication notice;
- cannot be fairly considered and responded to by the other party.

It is hoped that these requirements will prevent ambushes and protect against the Claimant’s lack of Reply to the Response. It is essential that the parties do not fall foul of these restrictions and equally essential that the Adjudicator maintains utmost vigilance to ensure that he does not take any regard of any submission, evidence or document that is non-compliant, resulting in jurisdictional challenges.

One topic that appears to be worthy of particular discussion is that of Expert Reports under the Adjudication process.

A key principle of Adjudication is that the Adjudicator should only consider the information put before him by the parties. In this respect, SOP Clause 19 empowers the Adjudicator to:

‘(g) appoint, with the consent of the parties to the adjudication, an independent expert to enquire or report on any specific matter’

Firstly, it should be noted that the exercise of such power is subject to the consent of the parties. In this regard, it must be assumed that the consent of both parties is required. Consequently, the Adjudicator must not unilaterally proceed with the appointment of an independent expert, nor should he proceed if only one of the parties grants consent.

Moreover, the terms of reference for any expert appointed by the Adjudicator must be carefully considered, particularly in respect of matters relating to extensions of time. As noted under SOP Clause 19 (g), the scope of any expert appointed by the Adjudicator is to inquire or report on any specific matter. On its face, this does not appear to encompass a complete independent forensic analysis on EOT entitlement.

By way of example, consider the situation where the Contractor contends that a compensation event has a 60-day delay, based on an impacted As-Planned versus As-Built Analysis, whereas the Project Manager considers the delay to be 5 days, based on a Time Impact Analysis. These are the respective positions advanced by the parties and are the matters to be determined by the Adjudicator, based on the information provided.

Consequently, it would not appear to be appropriate for the Adjudicator to engage an independent planning expert to establish a delay of 20-days using a Windows Analysis since neither party has advanced such a position. Rather, the expert should provide an opinion on the respective positions advanced by the parties only. To go further would appear to open up the Adjudicator’s award to a jurisdictional challenge.

Whilst the jurisdictional challenge could be avoided by the Adjudicator seeking the parties’ agreement to undertake such an alternative method of Delay Analysis, the expeditious nature of Adjudication would inevitably present serious challenges since:

1. The Adjudicator would first have to review and understand the issues before appointing an expert under meaningful terms; and

2. The expert would be unlikely to be able to establish and verify the facts and conduct a comprehensive assessment in the time available, resulting in a questionable conclusion.

Whilst challenges to the Adjudicator's appointment/jurisdiction are inevitable, they will hopefully be limited due to the narrow scope of matters to be referred to adjudication. Possible challenges include, inter alia:

- Initiating payment claim was non-compliant;
- Notified dispute is not the same as the payment dispute;
- Lack of set off and withholding notices against amounts due;
- Submission of documents not compliant with SOP Provisions Clause 21;
- The contractual claim handling procedure has not been concluded.

The latter item seems the most challenging and warrants further examination.

The Contractual Claim Handling Procedure

Paragraph 10 of the Technical Circular states:

'Under the SOP Framework, contractual claim handling procedures as specified in contract should be gone through before any claims for additional payment can be submitted for determination by adjudicators. As such, the contract administrator's assessment on such claims, including any EOT claim associated with the payment dispute, should have been conducted and notified to the contracting parties before it would be referred to adjudication.'

Whilst this may appear to be a straightforward condition, disputes about whether and when the claim handling procedure has been complied with are already commonplace and could present obstacles for parties wanting to escalate matters to the Adjudication process. Careful compilation and review of payment claims will be required by the submitting party to ensure they do not fall foul of this requirement.

Paragraph 10 of the Technical Circular is amplified by Paragraphs 9 (3) – (5) of the SOP Provisions:

- '(3) Notwithstanding sub-clause (1), a payment dispute, in respect of a claim of the Contractor for additional payment pertaining to the happening of a compensable event as specified in the contract, does not arise unless and until the Project Manager has notified the Contractor of its rejection and/or assessment of such claim or has failed to notify the Contractor of its acceptance, rejection and/or assessment of such claim within any timescales for the same specified in the claim handling procedure or, where no timescales are specified, within a reasonable time in accordance with the claim handling procedure.*
- (4) The claim handling procedure is any procedure provided in the contract in relation to a claim for additional payment pertaining to the happening of a compensation event as specified in the contract for the purposes of –*
 - (a) analysing and determining the liability for such payment; and*
 - (b) assessing the amount of such payment or assessing adjustments to rates and prices which may result in additional payment.*
- (5) Without prejudice to the generality of sub-clauses (3) and (4) of this SOP Clause, the claim handling procedure includes all steps from the notification of a compensation event under NEC Clause 6 (Compensation events) until the Project Manager has (or should have) notified the Contractor of its decision under NEC Clause 61.4 or otherwise the implementation of the compensation event under NEC Clause 66.1 (including changes to the Prices as a result of the compensation event).*

In respect of the above, both paragraph 10 of the Technical Circular and Paragraph 9 (3) of the SOP Provisions refer to claims for additional payment. Consequently, whilst this covers claims

for additional payment generally, and additional payment arising from EOT, claims for non-compensable EOT are excluded and cannot be referred to Adjudication in any event.

As noted earlier herein, it is only through a compensation event that a Contractor can claim additional payment for carrying out the works or be allowed additional time in which to complete them.

NEC Clause 60.1 sets out a number of events that are identified as compensation events. However, there may be other events that can fall under this definition depending on the choice of Option chosen. For example, Secondary Option X2 covers 'changes in the law' and additional compensation events can be added under Section 6 of Part 1 of the Contract Data.

It should be noted, however, that Clause 60.1 is subject to a number of amendments under DevB's Library of Standard Amendments, the most significant being:

Amendments:

- Sub-Clause 13: 5 alternative choices as to how weather conditions will be addressed;
- Sub-Clause 21: "Additional compensation events stated in Contract Data part one" – replaced.

Additions:

- Sub-Clause 21 [Replacement]: "A Change in Law as defined in clause [A1] of the *additional conditions of contract*.";
- Sub-Clause 22 [New]: "A shortage of labour which would have been unreasonable for an experienced contractor to have allowed for at the tender closing date.";
- Sub-Clause 23 [New]: "A suspension or reduction in the rate of progress of the carrying out of construction work or the supply of related goods and services under the contract by *the Contractor* pursuant to SOP Clause 37.";
- Sub-Clause 24: [New - Optional] "Subject to any default by the *Contractor* under sub-clause (4)(e) of Clause D26 of *additional conditions of contract*, cancellation or alteration by MTRCL at short notice of the date or timing of any Restriction, Possession or Isolation set out in the contract or previously agreed to by MTRCL."

Given the deletion of the original Sub-Clause 21 by virtue of its replacement by a new one, it would appear that there is no longer any provision for the inclusion of additional compensation events within the Contract Data part one under SOPP.

Common issues falling under claims for additional payment include, but are not limited to:

1. Evaluation of compensation events, including the effects of Early Warning Notices, Risk Review Meetings and notice periods;
2. Interpretation of the definition of Defined Cost and Disallowable Cost in the cost reimbursement Options;
3. The effect of items 1 and 2 above on the pain/gain share mechanisms in the target Options (C and D).

In respect of such claims;

1. Under NEC Options A and B the Contractor must prove an entitlement to additional payment, whether this be through the traditional mechanisms of variations or proving loss and/or expense;
2. In contrast, under Options C, D, E, and to some extent F, the Contractor is reimbursed all valid costs and the onus falls on the Client to show that any costs are inadmissible.

Consequently, Contractor's claims for additional payment pursued as compensation events pursuant to Clause 6 of NEC4 generally comprise the same issues arising under other forms of contract. However, under the cost reimbursement Options, the financial positions are effectively

reversed, leading to claims by the Client against the Contractor for disputing payment of costs incurred, in addition to delay damages and other financial deductions.

It is common knowledge within the industry that the administration of certain aspects of the Contract by the Client’s appointed representatives is governed by the terms of their appointment and/or the internal rules of the Client to obtain confirmation that the Client has no objection to their proposed course of action. This inevitably delays the making of decisions and the issuing of responses, instructions and the like on the Client’s side.

Such a constraint has been proactively addressed under Paragraph B1 of DevB’s Library of Standard NEC Additions, relevant parts of which are stated below:

Section B – Powers and Duties of Client, Project Manager and Supervisor

- B1 (1) Before carrying out any of its duties or exercising any of its powers under the contract, the *Project Manager* may be required under the terms of its appointment by the *Client*/under the internal rules of the *Client* to obtain confirmation that the *Client* has no objection to the *Project Manager’s* proposed course of action and, in the event of an objection, to act in accordance with the *Client’s* direction.
- (3) The *Project Manager* is required under the terms of its appointment by the *Client*/under the internal rules of the *Client* to obtain confirmation of no objection from the *Client* and, in the event of an objection, to act in accordance with the *Client’s* direction before giving any instruction changing the Scope or taking any other action which may commit the *Client* to an increase or a decrease in the Prices under the contract by a sum estimated to exceed HK\$800,000. This requirement shall not be applicable where the instruction changing the Scope or other action is considered by the *Project Manager* to be essential on grounds of safety or other emergency in circumstances when it is impracticable to refer the matter to the *Client* beforehand.
- (4) The *Project Manager* may, subject to any prior contrary instructions given by the *Client* to the *Project Manager*, give any instruction changing the Scope or taking any other action which may commit the *Client* to an increase or a decrease in the Prices under the contract without the need to obtain confirmation of no objection from the *Client* if the value of such instruction or commitment is estimated not to exceed HK\$800,000.

The additional time required for the PM to undertake his duties as a consequence of the above are reflected in the amendments to Clauses 61.4 and 62.3 under DevB’s Library of Standard NEC Amendments:

Clause	Action	Details	Rationale
61.4	Replace	“one week after the <i>Contractor’s</i> notification” with “[six weeks for events requiring to obtain confirmation of no objection from the <i>Client</i> in accordance with clause [B1] of the <i>additional conditions of contract</i> , or three weeks for other events] after the <i>Contractor’s</i> notification” at the first bullet point of the first paragraph in the clause.	To impose specific time limit for the <i>Project Manager</i> to notify its decision on compensation events to the <i>Contractor</i> . Approval should be sought from the relevant authorities in accordance with the Stores and Procurement Regulations (SPR) 520 and Appendix V(B) and the consultancy agreement terms where appropriate. The Project Offices should update the time in square bracket to suit their projects and

Clause	Action	Details	Rationale
			clause no. of the <i>additional conditions of contracts</i> on the <i>Project Manager's</i> powers.
62.3	Replace	"The <i>Project Manager</i> replies within two weeks of the submission." by "The <i>Project Manager</i> replies within six weeks for events requiring to obtain confirmation of no objection from the <i>Client</i> in accordance with clause [B1] of the <i>additional conditions of contract</i> , or three weeks for other events after receiving the submission." in the second sentence of the clause.	To impose specific time limit for the <i>Project Manager</i> to reply to the <i>Contractor</i> for its quotation for compensation events. Approval should be sought from the relevant authorities in accordance with the Stores and Procurement Regulations (SPR) 520 and Appendix V(B) and the consultancy agreement terms where appropriate. The Project Offices should update the time in square bracket to suit their projects and clause no. of the <i>additional conditions of contracts</i> on the <i>Project Manager's</i> powers.

In this regard, particular attention should be taken of the requirement that:

'The Project Offices should update the time in square bracket to suit their projects ...'

Whilst this comment applies to both Clause 61.4 and 62.3, it will be noted that the time stated within Clause 62.3 is not contained within square brackets. For the purposes of this review it is assumed that it should be, and the lack of square brackets is merely a typographical error.

Obviously, the actual period of time allowed for the PM to undertake his duties is likely to vary depending on the size and complexity of the project and the extent of the administrative layers within the relevant Government departments overseeing it. It must be assumed that the six-week period is the minimum period required for the necessary procedures to be followed. Whilst this may be achievable in simple, low value projects, it begs the question as to what is the likely timeframe for such processes in complex projects valued at multi-billions of Hong Kong Dollars with multi-layers of bureaucratic procedures to be followed?

If the PM is required to continually request the Contractor for an extension of the period for administering compensation events, this entirely defeats the purpose of the NEC Contract. Moreover, PMs do not like giving bad news and the Client does not like receiving bad news. The traditional approach has been to continually keep deferring the matter until the end of the project, and a continually extended approval time provides the perfect opportunity for this to happen.

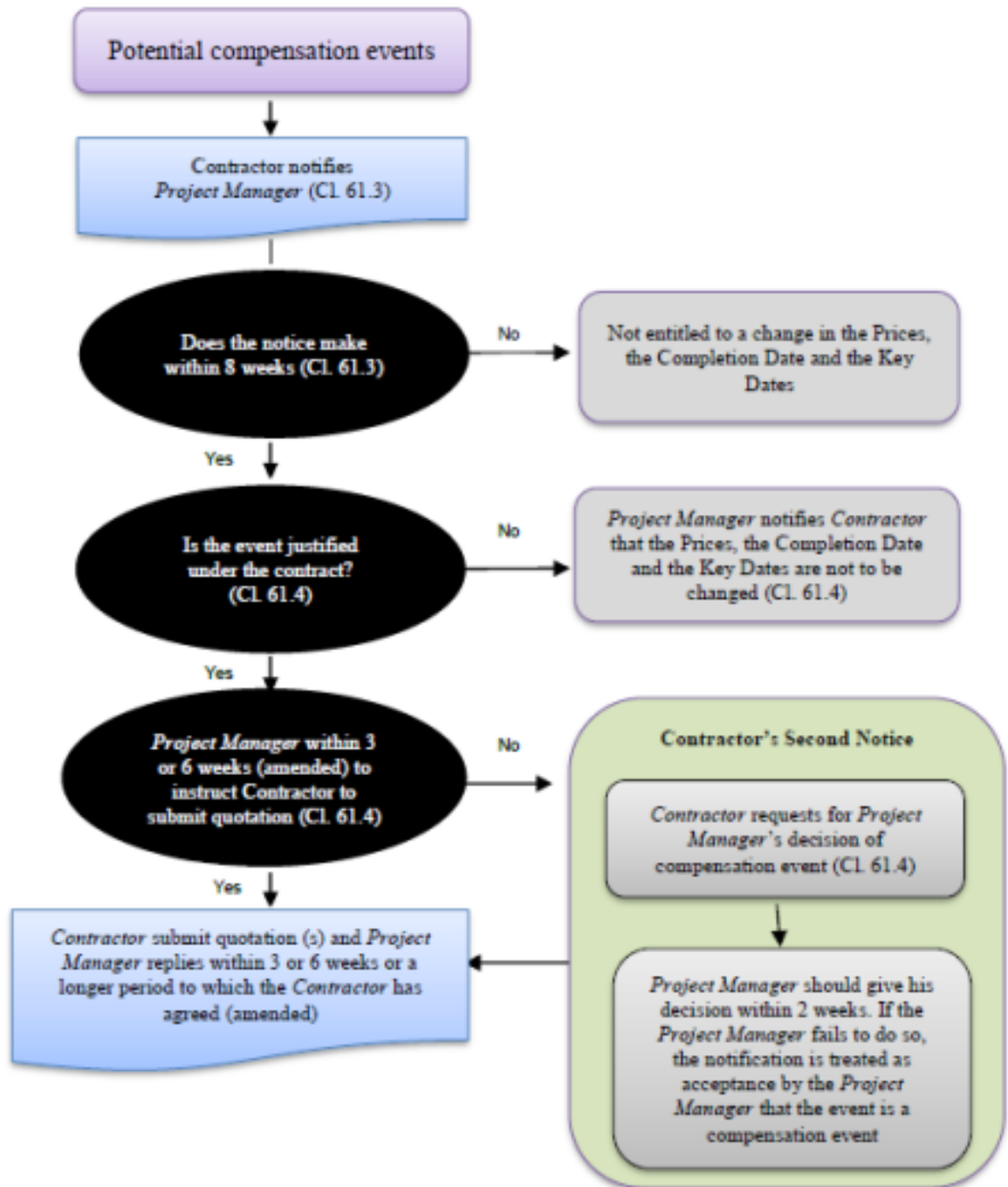
Worryingly, this places the Contractor in a wholly invidious position since it either has to accede to the request for additional time or deny the request, which will force it to initiate Adjudication on the matter. Despite this being the only remedy open to the Contractor, it seems difficult to imagine that such action would not result in it achieving adverse reports on its performance.

In respect of the contractual claim handling procedure, there are three key components:

1. Notification and acceptance of a compensation event in principle;
2. Submission and acceptance of the Contractor's quotation;
3. Implementation of the compensation event.

Guidance on these matters is provided under Section A6.3 of Development Bureau's Practice Notes wherein:

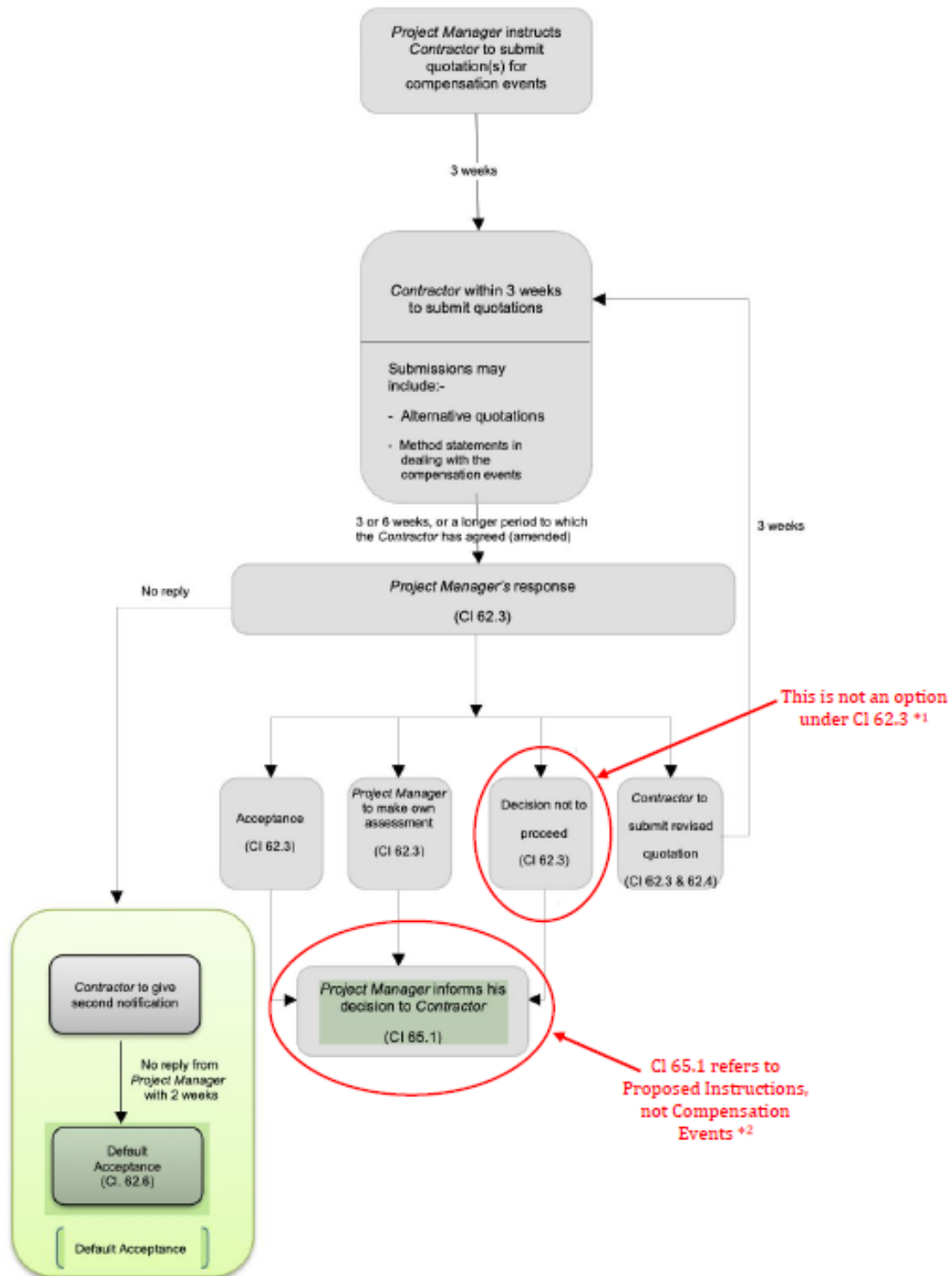
1. Paragraph A6.3.2.11 provides a process map for the notification of compensation events:



2. Paragraph A6.3.3.19 states:

'For consultants-administrated contracts, compensation events with estimated value over the sum (normally \$800,000) as specified in the consultancy brief or causing exceedance in the recommended forecast total of the Prices specified in the tender report would require sufficient lead time for the consultants acting as the Project Manager or his delegate to seek the Employer/Client's agreement in accordance with the consultancy requirements as appropriate. Both direct and indirect costs (e.g. preliminary/administration, charges and prolongation cost for potential extension of time which may affect the Completion Date and Key Dates) should be included in the estimate.'

3. Paragraph A6.3.3.21 provides the process map of evaluation of quotations for compensation events. However, as identified below, the process map appears to contain some anomalies when referenced against NEC4:



#1 In respect of the Project Manager’s response, NEC Clause 62.3 as amended under SOPP states that the Contractor shall submit quotations within three weeks of being instructed to do so by the Project Manager. The Project Manager shall reply within three or six weeks of the submission. The reply shall be:

- a notification of acceptance of the quotation;
- an instruction to submit a revised quotation; or
- that the Project Manager will be making the assessment.

As such, there is no provision for the Project Manager to issue a decision not to proceed.

#2 In addition, Clause 65.1, which is cited as being the clause under which the Project Manager's decision is issued, relates to proposed instructions, not compensation events. Clause 65.1 states:

'65.1 The Project Manager may instruct the Contractor to submit a quotation for a proposed instruction. The Project Manager states in the instruction the date by which the proposed instruction may be given. The Contractor does not put a proposed instruction into effect.'

Clause 65.2 states that the Contractor shall submit the quotation for a proposed instruction within three weeks of being instructed to do so and the quotation shall be assessed as a compensation event. Further, the Project Manager shall reply to the Contractor's quotation by the date when the proposed instruction may be given. The reply shall be:

- an instruction to submit a revised quotation including the reasons for doing so,
- the issue of the instruction together with a notification of the instruction as a compensation event and acceptance of the quotation or
- a notification that the quotation is not accepted.

If the Project Manager does not reply to the quotation within the time allowed, the quotation is not accepted.

Clause 65.3 states that if the quotation is not accepted, the Project Manager may issue the instruction, notify the instruction as a compensation event and instruct the Contractor to submit a quotation.

It would appear that the answer to this anomaly may be found at Paragraph A6.3.3.22 of the Practice Notes in respect of 'Implementation of Compensation Events':

'A6.3.22 The implementation of compensation events represents the formal conclusion of the administrative process. Implementation of compensation events take place when (NEC3 clause 65.1/NEC4 clause 66.1):

- (a) the Project Manager notifies his acceptance of the Contractor's quotation;*
- (b) the Project Manager notifies the Contractor of his own assessment; or*
- (c) the Contractor's quotation is treated as having been accepted by the Project Manager.'*

Given the foregoing, it is assumed that the reference in the flowchart to Clause 65.1 refers to NEC3 and should be corrected to Clause 66.1 in respect of NEC4.

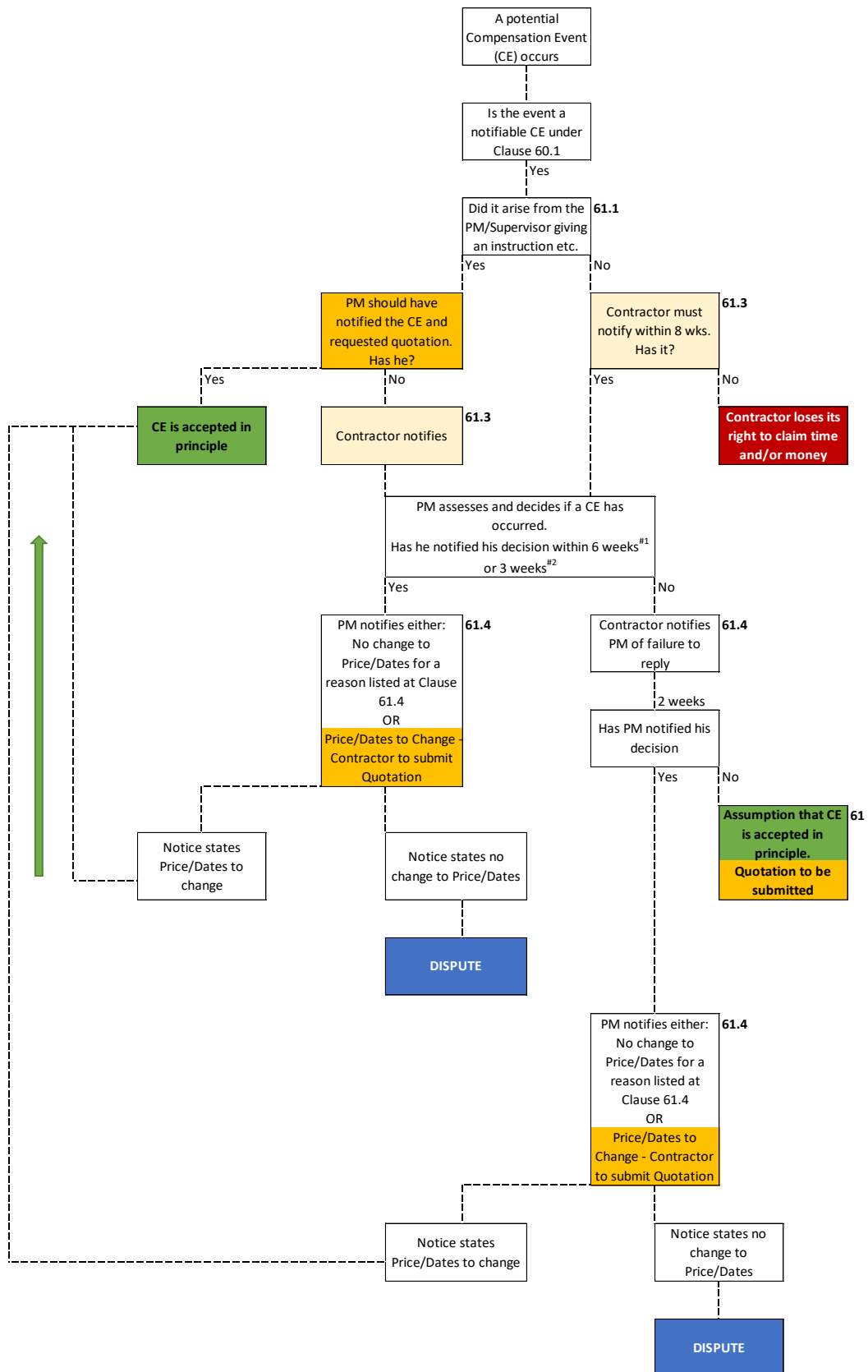
Whilst acknowledging that the aforementioned process maps provide a basic indication of the necessary steps to be taken, they do not portray the full sequence of events that may be necessary to ensure that the claim handling procedure has been fully concluded prior to the launch of an Adjudication. In this regard, they simply go from "A" to "B" in a somewhat idealistic approach. Experience suggests that the process is more likely to go from A to B via "C", "D" and/or "E".

By way of a simple example, the process map for the notification of compensation events under Paragraph A6.3.2.11 of the Practice Notes identifies only that the Contractor notifies the Project Manager under Clause 61.3, whereas Clause 61.1, which is not referred to, requires the Project Manager to notify the Contractor of a compensation arising from a Project Manager's instruction, notification, certification or change in an earlier decision.

Given the condition precedent to complete the contractual claim handling procedure before referring a payment dispute to adjudication, there needs to be full transparency as to what "the contractual claim handling procedure" actually comprises in its entirety.

The full sequences of events considering all scenarios are more likely to be as shown below:

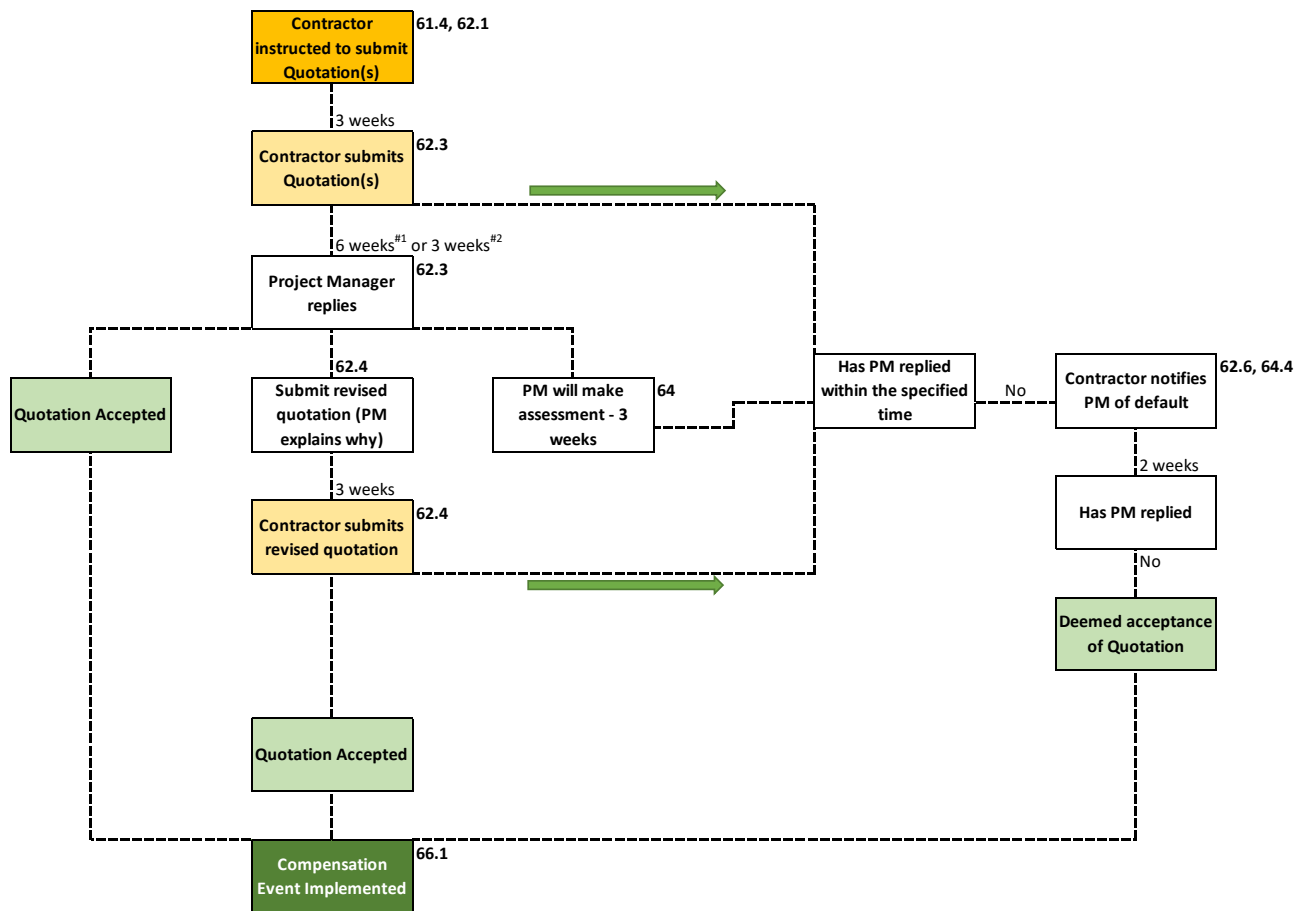
Notification of Compensation Event:



#1 For events requiring to obtain confirmation of no objection from the Client in accordance with clause [B1] of the additional conditions of contract

#2 For other events

Submission of Quotation and Implementation of Compensation Event:



#1 For events requiring to obtain confirmation of no objection from the Client in accordance with clause [B1] of the additional conditions of contract

#2 For other events

The requirement that no adjudication can take place until the contractual claim handling procedure has been concluded appears to be an area ripe for disputes to arise and one which needs to be carefully managed by the parties. Given that only one of the twenty Publics Works projects completed in the past three years exceeded HK\$1 billion in value (Tin Shui Wai Hospital: HK\$2.6B), practical experience on this matter seems to be limited. It remains to be seen by how much the administrative timeframes will need to be extended, particularly when there are multiple large-scale projects being undertaken concurrently.

In this respect, there are already six projects being undertaken under NEC with forecasted expenditure between HK\$6–10B, and with all new Public Works projects required to be undertaken under NEC, the number and the expenditure ranges will only increase. How the Government responds to this critical pressure point will be fundamental to the successful implementation of SOPP and the subsequent introduction of SOPL.

Challenges to Adjudicator’s Awards

The success of SOPP will largely be determined by how effective the Adjudication process is. Whilst there will inevitably be challenges to the Adjudicator’s jurisdiction and decisions, it is hoped that the restricted scope of matters that can be referred to Adjudication will help to minimise such occurrences.

Subjects covered by UK legal cases in the first 3 years of Adjudication include (items highlighted in bold are the ones considered to be most likely to feature in the early stages of SOPP):

1. Abatement;
2. Adjudication Provisions – validity;
3. **Adjudicator;**
4. Arrestment;
5. **Bias;**
6. Construction Contract/Construction Operations;
7. **Costs;**
8. **Date of Execution of Contract;**
9. **Enforcement;**
10. Human Rights Act/**Natural Justice;**
11. Injunction;
12. **Insolvency;**
13. **Jurisdiction;**
14. **Mistake;**
15. **Payment;**
16. **Set-Off;**
17. Stay of Execution in Court Proceedings;
18. Subsequent Proceedings;
19. Termination;
20. Waiver.

The UK Adjudication Report contains a section on the leading causes of disputes and the categories of claim referred to Adjudication. Whilst some of the items will be excluded from the scope of Adjudication under SOPP, the full findings of the report are listed below for reference. Again, items highlighted in bold are the ones considered to be most likely to feature in the early stages of SOPP unless and until the entrenched mindsets change:

Leading Causes of Disputes in Construction Adjudication (in descending order):

1. **Inadequate contract administration;**
2. **Changes by client;**
3. **Exaggerated claims;**
4. **Lack of competence of project participants;**
5. **Adversarial industry culture;**
6. **Unclear risk allocation;**
7. **Inadequate contract documentation;**
8. **Inadequate design documentation;**
9. **Inadequate design information;**
10. **Lack of professionalism of project participants;**
11. **Unrealistic time/cost/quality targets by Clients;**
12. **Poor communications;**
13. **Unrealistic tender pricing;**

14. **Client's lack of information or decisiveness;**
15. **Personality clashes;**
16. **Inappropriate payment methods;**
17. **Uncontrollable external events;**
18. **Unfair risk allocation;**
19. **Incomplete tender information;**
20. **Errors in work;**
21. **Inadequate brief;**
22. **Contractor's unrealistic information expectations;**
23. Inappropriate contract type;
24. **Slow Client response;**
25. **Estimating errors;**
26. Inappropriate Contractor selection;
27. Inappropriate contract form;
28. Vested interests;
29. Internal disputes (within JVs and the like).

Other causes of disputes not listed above included deliberate non-payment of monies due and a lack of understanding of the contract, both of which could be applicable under SOPP.

Most Common Categories of Claim Heads in Construction Adjudication (in descending order):

1. Extension of time;
2. **Final account;**
3. **Interim payments;**
4. **Variations;**
5. Defects;
6. **Damages;**
7. **Liquidated damages;**
8. Global claims;
9. Professional liability;
10. Non-monetary claims;
11. Quantum meruit.

Other categories of claim heads included termination and prolongation costs, with the latter definitely being applicable to SOPP.

The report also contains the following statement, which will hopefully be reflected in the forthcoming introduction of SOPL:

'The data above shows that adjudication is clearly no longer, if it ever was, a mere tool to ensure cash flow during the execution of a project. It is a dispute resolution procedure in its own right, which is capable of resolving all types of disputes that may arise under a construction context.'

In its comment within the current NEC4 ECC, DevB states that NEC4 is expected to further "unlock innovations". Whilst this is a welcome statement, it can only be realised if all other government departments embrace the same philosophy and act in tandem.

To date, government departments have not demonstrated a great desire to embrace innovations at the workplace level, so it remains to be seen how SOPP will assist in overcoming delays and

additional costs arising from the dogmatic and repetitive nature of Submission procedures for approvals, requests for alternative materials/methodologies and the like. Will such matters fall under the ambit of adjudicable disputes?

It is also important to reiterate that a payment dispute does not arise until after the conclusion of the claim handling procedure stipulated in the contract. The claim handling procedure includes all steps from the notification of a compensation event under NEC Clause 61.1 or 61.3 until the Project Manager has (or should have) notified the Contractor of its decision under NEC Clause 61.4 or the implementation of the compensation event under NEC Clause 66.1, including changes to the Prices as a result of the compensation event.

A further area of potential conflict arises from the claiming party's entitlement to suspend/reduce the rate of progress in the event of an unpaid admitted amount or an unpaid adjudicated amount. In this respect, it is essential that any party seeking to exercise this right fully complies with its any obligations before taking any action otherwise it will find itself in breach of the contract:

1. Service of Notice on Client/Main Contractor at least 5 working days in advance;
2. Taking reasonable steps within 5 working days to make the Client/Contractor aware of the Notice;
3. Check that the admitted/adjudicated amount remains unpaid in full before the intended starting date of the suspension/reduction.

Given the untrodden path surrounding the whole SOPP/Adjudication issue and the likelihood of jurisdictional challenges, it is essential that Hong Kong has in place:

- Good Adjudicators and Adjudicator Nominating Bodies;
- A clear and robust enforcement regime for Adjudicator's awards.

Challenges Facing Hong Kong - Conclusion

It is anticipated that the introduction of SOPP will largely benefit sub-contractors more than main contractors.

Main contractors normally get paid undisputed amounts by the Government on time - it is amounts claimed as additional and disputed amounts that are the problem. Clearly, contractors may potentially benefit from the speedy interim resolution of payment disputes resulting in interim payment pending final resolution by arbitration/litigation. However, sub-contractors appear to benefit more since there is greater certainty that undisputed amounts will be paid on time and if they are not, they can suspend or slow down the progress of the work. In addition, they have a strong weapon in their ability to seek direct payment of an adjudicated amount from the Government.

Now that a SOP regime has finally been implemented, the problems facing the industry will only improve if the system is used as intended at every level. There will undoubtedly be uncertainties and misunderstandings along the way but given the industry's enthusiastic support for change, it is hoped that a positive reaction to SOPP may encourage a quicker transition to SOPL, providing greater certainty in payment practices. In this respect, all eyes will be on the Government.

8: The Future – What About SOP Legislation and Non-Public Works Contracts Undertaken under NEC or Other Contracts

As stated in the various documents issued by the Government, the purpose of introducing the SOP Provisions into public works contracts is to:

1. Facilitate timely payments and speedy interim resolution of payment disputes in public works contracts until SOPL is in place;
2. Develop experience in implementing a SOP mechanism that will help to fine-tune the SOP process and lead to the smooth introduction of SOPL.

So, what of the future? What can be expected and will there be any fundamental changes between SOPL and SOPP?

There is enormous pressure for SOPP to be successful and for SOPL to be introduced at the earliest opportunity.

In addition to the vast majority of current Public Works Projects being undertaken under the NEC form, both the public and non-public works sectors have ambitious plans for the future expansion of Hong Kong's infrastructure. It is essential that these projects are all brought together under a meaningful and effective SOPL framework that provides transparency and consistency at all levels.

Future projects that will benefit from this approach include:

- Northern Metropolis;
- Kau Yi Chau Artificial Islands;
- Tung Chung New Town Extension;
- Kwu Tung North New Development Area
- Northern Metropolis Highway;
- Shatin Bypass;
- Tseung Kwan O-Yau Tong Tunnel;
- MTRC Hong Kong Section of the Hong Kong-Shenzhen Western Link connecting Hung Shui Kiu and Qianhai;
- MTRC Hung Shui Kiu Station;
- MTRC Central Rail Link connecting Kam Tin with Kowloon Tong via Kwai Chung;
- MTRC Tseung Kwan O Line Southern Extension;
- MTRC Tung Chung Line Extension;
- MTRC Oyster Bay Station and Siu Ho Wan Depot Development;
- MTRC Airport Railway Extended Overrun Tunnel;
- MTRC Tuen Mun South Extension;
- MTRC Kwu Tung Station;
- MTRC Northern Link.

For meaningful SOPL to be introduced as the much-needed and long-overdue remedy to the industry's cashflow problems, SOPP must firstly be effective and be seen to be effective. Given the manner in which the Government has chosen to introduce SOPP into the industry, it is the Government, and principally Development Bureau that must take responsibility to ensure the genuine introduction of SOPP as a fundamental and effective change to the manner in which the industry conducts itself.

In this respect, DevB has overall responsibility for, inter alia, infrastructure development, and is responsible for managing the following Government Departments:

- Architectural Services Department;
- Buildings Department;
- Civil Engineering and Development Department;
- Drainage Services Department;
- Electrical and Mechanical Services Department;
- Lands Department;
- Land Registry;
- Planning Department;
- Water Supplies Department.

It is therefore essential that not only does DevB proactively manage the departments under its control, but it also takes the lead in ensuring that other Bureaux, such as Housing and Transport & Logistics, plus their subordinate Departments, are equally receptive of the NEC ethos and actively contribute to the collaborative delivery of the Public Works projects. Without such a holistic and 'joined up' approach, it is difficult to see how the true objectives behind NECC and SOPL can be achieved.

In this respect, there are a number of key provisions in the July 2022 Practice Notes.

The purpose of the document is stated under Section 1, Executive Summary, emphasis added:

'1.1 PURPOSE OF THE PRACTICE NOTES

*1.1.1 To cater for the wider adoption of New Engineering Contract (NEC) form in public works projects in the coming years, the Development Bureau (DEVB) promulgates this Practice Notes to facilitate the Project Offices of the Works Departments (WDs) in the administration and management of NEC procurement for their projects. This Practice Notes is intended to be a living document and will be updated from time to time on a need basis. This Practice Notes aims to provide guidance, performance benchmarking and **alignment of practices of the Project Offices of WDs in the preparation and administration of public works projects and consultancy agreements using the NEC form.** The NEC form includes the Engineering and Construction Contract (ECC), Term Service Contract (TSC) and Professional Services Contract (PSC) which will be covered by three different Parts of this Practice Notes.'*

Sub-Section A6.7 provides guidance on "NEC Performance Monitoring", emphasis added:

'A6.7.1 Standard forms have been designed by DEVB for the Project Offices to input the data of the NEC contracts in respect of cost and time aspects. Regular return will be called by DEVB on a quarterly basis to collect data for monitoring the performance of NEC contracts. The concerned data will be input and retrieved through the Public Works Project Information System (PWPIS) after completion of system upgrade in early 2017 tentatively.

*A6.7.2 The Project Offices are encouraged to use suitable software or application to facilitate the contract administration, improve the management efficiency and enhance the project cost control if appropriate. The key functions of the software or application should include but not limited to **registration and monitoring of risk register, early warnings, prevention events and the Project Manager's instructions, monitoring and processing of programme updates, interim payment applications and notifications and quotations for compensation events, keeping and processing of site diary and other site records,** etc. The software or application should facilitate the communications amongst the Employer/Client, the Project Manager, the Supervisor and the Contractor. The software or application should allow a function to **generate real time management reports** regarding the project cost, covering but not limited to **the latest forecast final total of the Prices, current and estimated final Price for Work Done to Date, Defined Cost, Fee and***

Disallowed Cost, implemented compensation events and outstanding quotations for compensation events, price adjustment for inflation, other expenditure (e.g. the Contractor's share, incentive payments, delay damages), etc. The software or application should enable data export, backup and recovery, and have access right control and data security functions. Relevant requirements should be specified in the Works Information/Scope.'

Section A7 is titled "Knowledge Sharing Among NEC Users" and key contents include, emphasis added:

'A7.1 At present, there are several committees in DEVB / WDs in relation to the adoption of NEC in public works projects:

- **Steering Committee on NEC Projects (meeting on need basis): To oversee the implementation and steer the direction (chaired by PAS(W)4, DEVB)**
- **Inter-departmental Working Group on NEC Projects (meeting on need basis): To co-ordinate and advise WDs on matters relating to NEC (chaired by CAS(W)7, DEVB)**
- **Departmental NEC Working Group or equivalent (meeting regularly / on need basis): To support the use of NEC within individual departments. Members involve staff from the Project Offices adopting NEC (chaired by D1 / D2 / D3 officers in WDs)**

A7.2 **In view of the extensive upcoming NEC contracts, it would be beneficial if knowledge sharing could be done in a coordinated manner to facilitate WDs' preparation for NEC contracts, and to ensure a more consistent approach for all NEC contracts.** In addition, after issuing this Practice Notes, feedbacks or comments from users are expected. To this end, the Inter-departmental Working Group on NEC Projects is proposed to be a knowledge exchange platform for further development or refinement of this Practice Notes in a medium term.'

Thus, the framework exists for coordinating and standardising the truly collaborative approach envisaged under NEC. It is therefore essential that under the various committees and working groups that have been set up, the practices of the various Project Offices and Works Departments and the administration of all aspects of the Public Works Contracts delivered under NEC4 are fully aligned.

The obligations imposed on the Project Manager are fundamental to the successful completion of projects under NEC4/SOPP and critical matters need to be addressed and resolved in a timely manner.

Critically, the Contractor's issuance of Early Warning Notices ('EWNs') and Notices of Compensation Events ('NCEs') are contractual requirements in respect of matters that may affect time, cost or completion. Consequently, it is not appropriate for:

1. The Project Manager not to accept EWNs for fear of worrying/upsetting the Client;
2. The Client to say that raising EWNs/NCEs is "too contractual";
3. The Client to say that if EWNs/NCEs are raised, it will give no more work to the Contractor/Consultant;
4. The Project Manager to repeatedly extend the specified timeframes for actions on EWNs/NCEs, simply to avoid being the bearer of bad news to the Client.

Such practices entirely defeat the purpose of NEC project delivery since:

1. the Project Manager cannot manage and/or reduce risk; and
2. ultimately, the Client cannot benefit from the process.

If these fundamental issues are addressed under SOPP, there is no reason why Hong Kong cannot join the growing number of jurisdictions who have successfully implemented SOPL within their construction industries.

Whilst there is currently no definitive timetable for the enactment of SOPL, a number of key components are already identified:

1. Its scope will cover:
 - Public Sector: All construction contracts and related goods and services
 - Private Sector: Main contracts for construction with original price over HK\$5 million
Contracts for related goods and services with original price over HK\$0.5 million
Coverage extends to both new build and repair/alteration works
2. Sub-Contracts: All tiers of sub-contracting will be included if the main contract is covered, irrespective of price
Supply-only contracts will not be covered
3. Interim Payment The contractor is entitled to receive interim payments.
The parties are free to agree the timing of interim payments
Progress milestones can be used and do not have to be monthly
If no timeframe is agreed, the default period is monthly payments
4. Payment Process A statutory payment claim must be made in respect of the amount due
The paying party responds in 30 days and pays the admitted amount within 60 days of the payment claim
No response from the paying party means the payment claim is deemed to be rejected, but no set-off can be raised later
5. Remedy If a party is not paid the admitted amount or adjudicated amount it may, subject to notice, suspend or slow down the progress of work
6. Disputes All payment disputes can be referred to Adjudication, which is fast-track and binding in the first instance
Payment disputes include:
 - Delay/disruption payment claims and related EOT/delay damages claims, but only after the contractual claim process has been concluded
 - Set-off claims
7. Adjudicator Statutory register to replace the DevB register of ANBs established under SOPP
8. Enforcement A party can apply to the Court to enforce an Adjudicator's Award pending final resolution in arbitration/litigation, or to set it aside

It is anticipated that the introduction of SOPL will benefit both main contractors and sub-contractors through:

1. Greater certainty that undisputed amounts will be paid on time;
2. The ability to suspend or slow down progress and recover additional costs of doing so if payment is not made on time;
3. Speedy interim resolution of payment disputes resulting in interim payment pending final resolution by arbitration/litigation

Whilst some Developers and others may see SOPL as a disadvantage, they will ultimately benefit too from lower tender prices due to the benefits to contractors and sub-contractors gained from the reduced risks of late/non-payment.

In conclusion:

1. Hong Kong needs SOPL;
2. Hong Kong wants SOPP to work in order to facilitate SOPL;
3. Hong Kong **needs** SOPP to work in order to facilitate SOPL.

Whether or not these goals are achieved will require a fundamental shift in attitude from all sides, but most especially the Government who must demonstrate that it is the advocate of best practice across the industry.

9: Conclusion – the Elephant in the Room

There is little doubt that for both SOPP and SOPL to be effective, there has to be a fundamental shift in mindsets and practices on the part of all participants in the construction process. The various documents produced by DevB identify key areas that need to be changed and DevB is to be commended for its proactive approach in trying to facilitate the smooth introduction and operation of SOPP. But is this enough?

It cannot be denied that the biggest challenge facing the introduction of SOPP and SOPL in Hong Kong is the Government itself – it is simply not set up to operate in a manner that facilitates the two core principles of SOPP that it espouses, namely:

1. the timely processing of contractual payments; and
2. the speedy resolution of payment disputes.

An over-abundance of caution and bureaucracy stifles innovation and decision making, resulting in a culture whereby no decision is considered to be a better option than one that may be challenged by superiors, albeit that the latter allowed the project to proceed. In addition, considerable resources are spent monitoring and checking the Contractor's procedures and performance to a suffocating level, whereas those resources would be better spent in supporting the Project Manager and others working on the Client's behalf to speed up the reporting and approval processes to meet the real objectives of SOPP/SOPL.

Nowhere is this problem more evident than in the unique requirement introduced in Hong Kong that expressly requires the contractual claim handling procedure to be completed before a payment dispute can be referred to Adjudication. It is quite often the case in other jurisdictions that it is precisely because the contractual claim handling procedure has not been completed expeditiously, or at all, that matters are referred to Adjudication for resolution.

It is difficult to see this requirement being used as anything other than a deterrent to stop disputes being referred to Adjudication, which simply means that the existing problems of inaction and inertia will be continued.

The concerns raised above and elsewhere in this article are succinctly identified in a very incisive article titled "*When to Use NEC – What They Don't Tell You and You Should Know*", recently published by Patricia Haywood of Haywood Commercial. With due acknowledgement to the author, the contents are repeated below:

1. It is often recommended that you use NEC

The NEC doesn't work for every project despite the view in the market. You need to be able to decide for yourself if it is right for you.

2. Governance

You need to have a good governance structure for the project, with competent (and capable) people to make and implement decisions.

The governance team should sit within the project. On many major projects, the governance team doesn't sit within the project. What it means in reality, is that the project leadership team cannot make decisions for the project. Sometimes, they are mere figure heads.

3. Power

The governance team needs to have the power to make some decisions, if not all. All the power cannot sit outside of the project governance team.

The Governance team needs to have the power to make decisions. On many major projects, the team is not empowered to make the simplest decisions. Everything has to pass to the organisation's leadership team, meaning it is almost impossible to meet the NEC deadlines.

4. Compliance

You must comply with the clauses within the timeframe for things to be valid. Compliance can be expensive - you need to have enough people to do everything required.

Compliance can be expensive, especially if you are not naturally set up to comply with such contracts. If you quickly put things in place for just one contract, it will be expensive for you. The initial costs may be high and taper off as you build the know-how and capacity, but you must budget for compliance.

5. Speed

You need speed to comply with NEC. You cannot drag your foot on anything, “*time-barred*” is a concept to master.

We can learn a thing or two from IT projects. Sprints need to be mastered and an appreciation for doing things at pace - and not the public sector definition of “*at pace*”. You really must be able to turn around things quickly.

6. Quality

You not only need speed, but you also need to be able to produce quality. The team needs to be quick, competent and have a good quality of service.

While you are sprinting, you must produce high-quality work, documentation etc. Your output must not suffer to the point where the NEC becomes the obstacle - this is when the project starts to break.

7. Conclusion

The NEC is a good contract if the project is built around it - so many projects are not. If you know the project and the major players are not set up to run a NEC project, advise them to use another contract.

Food for thought indeed, and challenging times ahead, particularly in making Adjudication readily accessible under SOPP. But it doesn't have to be this way.

Adjudicators are professional, expert and, above all, independent arbiters of the dispute referred to them and should be both encouraged and allowed to issue decisions that reflect these characteristics. This is the only way to genuinely test the effectiveness of SOPP and to achieve constructive practical experience and feedback to facilitate meaningful refinement to the proposed SOP Bill.

Since the award can be challenged under arbitration and since NEC Clause 53.4 has been amended to prevent the Government from being debarred from initiating legal action after assessment of the final amount due, the Adjudicators' decisions are not final, and the Government still retains the right to challenge them – but only if necessary.

Thus, if the Government still needs to follow its current procedures of having disputed amounts verified by independent Experts, it can still do this to verify the Adjudicator's award and challenge it, if necessary, but at least the whole purpose of facilitating cashflow during the currency of the project will have been achieved in the meantime.

The Final Word

As noted in the Introduction to this article, the author has sought to shed light on the challenges facing Hong Kong in the introduction of a Security of Payment regime, initially as contractual 'Provisions', to be followed by statutory 'Legislation'.

The path to success will be challenging as identified herein, but it is not impassable and it is hoped that events will turn out to be a little different in practice, especially over time.

If you would like more information on this topic or would like to discuss any other matter with our team, please do not hesitate to contact us:

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