

Construction Industry Council

Committee on Procurement

Meeting No. 002/13 of the Committee on Procurement was held on Wednesday, 19 June 2013 at 2:30pm at Meeting Room No.1, CIC Headquarters, 15/F, Allied Kajima Building, 138 Gloucester Road, Wanchai, Hong Kong.

Present : Tai-chong CHEW (TCC) Chairman
Allan CHAN (SKC)
Anthony CHAN (AnCN)
Paul CHONG (PC)
Reuben CHU (RCU)
Kevin POOLE (KP)
Steve GRIFFIN (SGN) MTR Corporation Limited
Thomas Kwok-kwan HO (KnH) Hong Kong Institute of Surveyors
Kelvin LO (KLo) Development Bureau
Raymond NG (RyN) Independent Commission Against Corruption
Mung-wan WONG (MWW) Hong Kong Housing Authority
(*on behalf of Duncan PESCOD and Mrs. Irene CHENG*)

In Attendance : Kwok-hung LI (KkHL) Civil Engineering and Development Department
Winnie AU (WA) CLP Power Hong Kong Limited (*on behalf of Sing-mo HO*)
Fat-yau CHAN (FYC) Architectural Services Department (*on behalf of Rocky FOK*)
Alex LEUNG (AL) Senior Manager – Council Services 1
Carmen LIU (KML) Manager – Council Services 6
Patsy WONG (PyW) Senior Officer – Council Services

Presenter : Peter HO (PrH) Langdon and Seah
Peter NG (PNG) Association of Consultant Quantity Surveyors
Michael SZETO (MST) Hong Kong Construction Sub-Contractors Association

Apologies : Siu-hung CHAN (SHC)
Duncan PESCOD (DWP)
Irene CHENG (ICG) Hong Kong Housing Authority

Peter Kar-shing CHENG	(PChg)	New World China Land Limited
Sing-mo HO	(SMH)	CLP Power Hong Kong Limited
Andrew SIMPSON	(ASN)	Centari Consulting Limited
Rocky FOK	(RF)	Architectural Services Department

PROGRESS REPORT

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2.1 Confirmation of the Progress Report of the Committee Meeting No. 001/13

Members took note of the Paper CIC/PCM/R/001/13 and confirmed the Progress Report of Meeting No.001/13 of the Committee on Procurement (Com-PCM) – Open-Door Session and Closed-Door Session held on Wednesday, 20 March 2013.

2.2 Matters Arising from the Previous Meeting

(a) Item 1.6 – Open-Door Session – Report of the Task Force on the Selection of Consultants and Contractors

Regarding the proposed change of chairmanship for the Task Force on the Selection of Consultants and Contractors, KP reported that he would shortlist some potential candidates for discussion with TCC after the meeting. KP further advised that he would continue with the leadership of the Task Force until a suitable candidate was appointed as the new Task Force Chairman.

(b) Item 1.13(iii) – Closed-Door Session – Issues relating to “estimated quantities provided as reference to lump sum tender but not forming part of the contract”, “elimination of all entitlement to EOT” and “demand to submit signed and undated BA Forms”

It was reported that, after incorporating the comments from CIC’s legal advisor, the Buildings Department and the Council, the finalised set of Alerts on “Recent Issues of Concern on Tendering of Construction Contracts” was published in the CIC website in May 2013.

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2.3 Issues on On-Demand Bond

Members took note of the Paper CIC/PCM/P/011/13 regarding the issues on on-demand bond. Members deliberated on the subject as follows:

(i) Discussion at Council Meeting No. 002/13

AL briefed Members on the Council's discussion at Meeting No. 002/13 regarding the issues on on-demand bond, and in particular, the Council's comments concerning Com-PCM's proposal to commission a consultancy study to explore the nature, prevalence and significance of the issues. It was reported that, at the meeting, a Council Member commented on the extended period of time required to undertake a consultancy study, and suggested that, in order to look for possible solutions within a short period of time, the Council should leverage the knowledge and experience of Members to iron out the root cause of concerns. Council Member, Sr Bay WONG, was hence invited to nominate one or two experts in the field of quantity surveying (QS) to share their practical and professional insights on the subject. Council Members, Mr. Lawrence NG and Mr. Anthony CHAN, were also invited to share thoughts on the subject from the small to medium-sized main contractors and sub-contractors' perspectives.

(ii) Experience Sharing by Quantity Surveyors

PrH and PNG (representatives of two QS experts nominated by Sr Bay Wong) delivered a presentation on "Performance Bond - Experience Sharing for Committee on Procurement of the Construction Industry Council". A copy of the presentation material was enclosed in the tabled Paper CIC/PCM/P/015/13.

PrH briefed Members on the types, purpose and function of bonds and the operations of the two types of performance bonds, namely default bonds and on-demand bonds. He also shared with Members on the current market situation concerning the use of bonds.

PrH stated that the use of on-demand bonds was common

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in Singapore, and that, in Hong Kong, on-demand bonds were required in construction contracts for the Hong Kong Housing Authority (HKHA), Airport Authority Hong Kong (AAHK), MTR Corporation (MTRC), and Disney projects. For private sector construction contracts, PrH advised that on-demand bonds were only used by Sino, Wheelock and Swire Properties, and that they were not commonly used by other private developers.

PrH highlighted a number of concerns and impacts of on-demand bonds and the considerations by both the employers and contractors. He stated that, on the employer's side, additional costs would be involved and this would be reflected in the tender sum, but the protection to the employer would be as good as cash security. On the contractor's side, the key concerns were that (i) on-demand bonds might hinder the contractor's cash flow and tie up its bank facilities; (ii) small-sized contractors might encounter difficulty obtaining bond from the surety; and (iii) it could be risky for the contractors (or sub-contractors) if the employers (or main contractors) abused the system and called the bond just as they wished.

PrH advised that default bonds, cash deposits, guarantees (e.g. personal guarantees or parent company guarantees), pre-qualification on tenderers and financial check of successful tenderers before the award of contract might be served as alternatives to the use of on-demand bonds.

With respect to the application of on-demand bonds in consultancy agreements, PrH advised that on-demand bonds were not normally required by private developers in Hong Kong, although they had been used by major corporations such as the AAHK and MTRC.

To conclude, PrH suggested several key elements for further research/consultancy study if so demanded. These included a study on the effect of on-demand bonds on tender price; the availability of alternative protection measures; the ease of contractors in procuring on-demand bonds from surety; surety's view on the different types of bonds; the appropriate bond amount; and the relevant legal

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cases on bonds.

(iii) Sharing of Views and Concerns by the Main Contractors, Sub-contractors and Consultants

SKC, AnCN, MST and RCU shared with Members their views on the use of on-demand bonds from the main contractors, sub-contractors and consultants' perspectives. Key points of discussion were as follows:

- SKC expressed that he concurred with the points presented by PrH regarding the contractors' concerns on on-demand bonds. He added, however, that apart from the three major private developers stated in PrH's presentation, there were other medium-sized developers that used on-demand bonds.
- SKC highlighted to Members the disastrous effect that the calling of a bond had on the creditability of the contractors and stated that the use of on-demand bonds was too onerous for the contractors. He further commented that performance bonds which required some form of certification by the Architect or the Engineer or the like would be a more reasonable and acceptable instrument to the contractors than on-demand bonds.
- AnCN shared with Members his experience as a small-sized main contractor. He stated that some of the developers did request bonds, whether on-demand or default bonds. Whilst trying to negotiate for waiving such provision, AnCN noticed that sometimes the requirements on bonds were imposed by the banks financing the projects. He commented on the financial arrangement of private construction projects in Hong Kong and the risk exposures involved in dealing with small-sized developers or shell companies.
- AnCN further commented that the requirements on bonds would lead to a significant increase in costs and might limit the number of contractors willing to tender for the projects particularly in a blooming construction market.
- In response, Chairman commented that, as PrH

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indicated, the additional costs incurred would be passed onto the employers through the tender price. Employers, knowing additional costs would incur, still opted for the use of bonds because they felt that after evaluating the project/enterprise risk profile, bonds and/or other forms of securities were needed as risk mitigation measures.

- MST, representative of Mr. Lawrence NG, shared with Members the views from the sub-contractors' perspective. He expressed that the sub-contractors generally did not support the use of bonds of any types, as they increased the costs of the projects. MST further raised concerns on the practices of employers requesting bonds without any expiry dates in Hong Kong. He stressed that normally it took over two or three years for bonds to be released and this greatly hindered the cash flow and bank facilities of the sub-contractors.
- RCU shared with Members the views from the consultants' perspective. He stated that consultancy agreements generally had a much shorter period and lower contract sum compared to construction contracts. The number of consultancy firms in Hong Kong was also comparatively small and that the firms were generally well-established. Given professional indemnity insurances were already in place, RCU queried on the necessity for and the reasons behind the use of bonds in consultancy agreements.

(iv) Sharing of Views and Current Approaches by the Employers

Representatives from the employer organisations shared with Members their views and current approaches on the use of bonds. Key points of discussion were as follows:

- KP shared with Members AAHK's approaches to the use of bonds. He stated that AAHK required bonds by their contractors but not always by their consultants. KP further advised that historically bonds were requested without an expiry date, but recently AAHK had revised

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its practice and assigned a fixed expiry date, i.e. usually on the date of substantial completion, as well as reduced the bond amount. KP also shared with Members his previous UK experience and highlighted the difficulties involved in enforcing default bonds.

- In response to KP's query regarding the statement "on-demand bonds were not commonly used [by private developers]" made by the QS experts, PrH clarified that his study covered only the major developers but not the second-tier small to medium-sized developers.
- SGN shared with Members MTRC's approaches to the use of bonds. SGN expressed that MTRC considered the use of bonds as part of a suite of securities. He advised that, in general, bonds were required for construction contracts exceeding certain sums but not for consultancy agreements and that MTRC adopted a flexible approach in deciding on the necessity of bonds. In terms of the expiry date of bonds, SGN stated that approximately 80% of its bonds had an expiry date specified by an event (e.g. on substantial completion of the works), whilst the remaining 20% had a fixed date specified (e.g. 3 months after the anticipated substantial completion date).
- SGN further pointed out that over the past twenty years he saw a decrease in the use of on-demand bonds in Hong Kong both in terms of the bond amount and the number of employers that used on-demand bonds.
- KLo advised that the Development Bureau had waived its standing policy on requesting bonds in construction contracts since the 1997 and that currently bonds were only imposed on particular projects such as those involving tight construction programme, high risks or co-funding with China.
- MWW shared with Members that, as part of its risk management system, HKHA generally required the contractors to obtain on-demand bonds for most of its

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new works projects, except minor works projects.

- In response to the suggestion raised at the last Council Meeting regarding phased reduction of on-demand bond as the works progressed, SGN stated that employers would usually require the bonds be maintained until the end of the projects because, even if a project was 80% or 90% completed, there was still a risk that the remaining part of the works (a percentage of works of contract sum higher than the bond amount) might not be done.
- SGN stressed that the issues on bonds should not be considered on its own and that before requesting for the removal of a bond, one must look at the alternative securities that were available to the employers in lieu of the bond. SGN further stated that default bonds were generally not attractive to the employers because of the difficulties involved in enforcing the bonds.

(v) Members' Deliberation

Chairman expressed that, having heard the presentation from the QS experts and the views and concerns of the contractors, subcontractors and consultants as well as the employers, he concurred with the Council Member that a consultancy study on on-demand bonds might not help to solve the issues. Instead, he invited Members to deliberate on whether the issuance of guidance notes, in the form of an Alert or the like, giving recommendations on good practices in relation to the use of on-demand bonds, would be a more appropriate and acceptable way forward.

SKC emphasised the detrimental effect that the calling of a bond had on the creditability of the contractors and reiterated that Hong Kong Construction Association (HKCA) generally did not accept the use of on-demand bonds and that it was not just about the level (or the percentage) of the bonds. SKC stated that, from HKCA's perspective, the use of on-demand bonds should be removed completely and that the issuance of guidance notes giving recommendations on good practices was insufficient. He suggested that, as a minimum, a clear

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statement stating that “CIC does not support the use of on-demand bond in the construction industry” was required.

PC expressed that the issues on on-demand bonds carried even heavier impact on the sub-contractors than the main contractors. He highlighted the difficulties the sub-contractors faced in obtaining on-demand bonds for the main contractors. Nonetheless, PC maintained a neutral stand on the issues because, as he put it, bond did serve its purpose in some circumstances. He suggested that, if the Council was to commission a consultancy study on the use of on-demand bonds, the study should investigate the current usage of bonds in Hong Kong, whether they were being abused or used unnecessarily as well as the effectiveness of bonds.

Chairman and KP stated that, while understanding fully the concerns and difficulties faced by different stakeholders, it would be inappropriate for the Council to make an assertion that “no on-demand bond should be used in the construction industry”.

KP and SGN stressed that an on-demand bond responsibly managed was an effective risk management tool. They agreed with the Chairman that the issuance of an Alert or the like reminding “industry stakeholders to act in a responsible and appropriate manner when implementing on-demand bonds” would be a more appropriate and acceptable way forward for the Council.

KnH expressed his view that, as a free market, restriction should not be imposed on the use of on-demand bonds in Hong Kong.

KLo reiterated that it would be inappropriate for the Council to request for a bar on the use of on-demand bond across the industry because, in addition to offering purely monetary compensation, on-demand bonds might also serve the benefit of ensuring proper performance of the contractors.

After much deliberation, Chairman concluded that there

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were differing views within the Com-PCM and that whilst Members from the main contractors and sub-contractors' associations were in favour of requesting support from the CIC to put a ban on the use of on-demand bonds across the industry, Members from the employers' organisations considered that on-demand bonds were needed as part of their risk management plan. No consensus could be reached amongst Members on the way forward.

Chairman urged Com-PCM to give thought again on Members' discussion and suggestions (including the idea of issuing an Alert or the like to give recommendation on good practices in relation to the use of on-demand bonds) for further deliberation at the next meeting.

[MST, PNG and PrH left the meeting at 4:00pm]

2.4 Issues on Construction Programme

AL introduced the Paper CIC/PCM/P/012/13 which set out the background to the issues on construction programme and the views received from HKHA and HKCA on the subject.

MWW shared with Members the outcome of a workshop that HKHA held in early 2013 to explore initiatives to "expedite construction, streamline processes, assure safety, quality and human resources for public housing construction". He highlighted to Members some of the initiatives identified, including (i) streamlining administrative procedures, (ii) extending the use of precast construction techniques, (iii) shortening the time for construction cycle in typical floors; and (iv) exploring the use of other construction techniques.

SKC expressed HKCA's view regarding the need to set a benchmark for reasonable construction programme for different types of works in Hong Kong. He suggested the Council to consider commissioning researches to:

- compare the method of construction and average construction time of similar economies (e.g. Singapore, Japan, Korean, Australia and Europe); and
- review critically the inter-relationship of commonly

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adopted local designs, the normal methods of construction, the number of workers required and the reasonable time of completion.

In response to HKCA's suggestions, a Member commented that whilst it might be possible to gather basic data, such as the commencement and substantial completion dates of standard housing projects, from HKHA to work out ballpark construction rates for typical public housing works, gathering of information and determination of average construction rates for private sector and civil engineering works projects might be problematic or non-conclusive. Members further suggested that, if researches were to be commissioned, they should more appropriately be focused on local experience.

Given the vast amount of variables and site/project-specific factors involved, Chairman questioned on the feasibility and appropriateness for the Council to set benchmark on construction periods for the wide variety of works in Hong Kong. To echo Chairman's point, KP commented on the difficulties involved in achieving a reasonable benchmark and expressed doubts on the usefulness and representativeness of such benchmark values. KP also doubted on whether sufficient data would be available to the Council for setting benchmark and the amount of work that would be involved.

KP recommended Com-PCM to consider issuing a one-page Alert, as an alternative to research studies, to draw the industry's attention to the importance of a workable construction programme. He suggested that the Alert could forewarn the industry of the potential impacts of a highly-compressed construction programme on the quality, safety and cost of the works and recommend the employers to seek professional advice, where necessary, on establishing an achievable construction programme at the project outset.

Chairman invited KP to contribute in the drafting of the Alert, if agreed to be issued in future, and invited SKC to give suggestions on the proposed scope of a possible research study for further deliberation at the upcoming meeting(s).

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2.5 Report of the Task Force on Competition Law

Members took note of the Paper CIC/PCM/P/013/13 regarding the recent publications and deliverables of the Task Force on Competition Law.

AL reported that the following publications which aimed at introducing the Competition Ordinance and its potential implications for the construction industry were issued in the preceding months:

- a Procurement Fact Sheet on the Competition Ordinance published at the CIC website;
- an article entitled “ Hong Kong’s New Competition Law: An Introduction” published in the CIC Newsletter; and
- an article entitled “Construction Industry Prepares for the Competition Law” and “建造業為競爭法作準備” published in *The Standard* and *Hong Kong Economic Times* respectively on 8 April 2013.

AL further reported that a Competition Law cum Security of Payment Forum was successfully held on 3 May 2013 to help inform construction industry stakeholders, small and medium-sized enterprises in particular, the key provisions of the Competition Ordinance and some practical steps to avoid infringing the new law. Members commended the event and publications.

2.6 Report of the Task Force on NEC3 Collaborative Contracts

AL briefed Members on the progress of the Task Force and Task Group on NEC3 Collaborative Contracts.

Members were advised that the drafting of a Frequently Asked Question (FAQ) document on NEC3 Collaborative Contracts was in progress. Subsequent to the last meeting of the Com-PCM, the Task Force on NEC3 Collaborative Contracts reviewed the preliminary draft FAQ document and provided comments for the Section Leaders’ consideration.

Members were further advised that, in May 2013, Section Leaders revised the document taking into account the Task

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Force comments and that the revised draft FAQ document was under review by an Reviewer (identified within the Task Force) to ensure consistency and adequacy of the document. Subsequent to the Reviewer's review and editing, the draft document would be circulated to the Task Force for another round of comment.

AL reported that the Section Leaders and the Reviewer would continue to edit the draft FAQs, and, if appropriate, circulate the draft document to Real Estate Developers Association (REDA) and/or Independent Commission Against Corruption (ICAC) for comment and hold further Task Force meeting(s) to fine-tune the document before finalising it for formal submission to the Com-PCM in 2014.

2.7 Report of the Task Force on the Selection of Consultants and Contractors

Chairman of the Task Force on the Selection of Consultants and Contractors, KP, updated Members on the status of the draft Reference Materials on the Selection of Consultants.

Members were advised that a Task Force meeting was held on 11 June 2013 to review the draft document edited by the Report Editor, Ms. Brione BRUCE, and that Task Force Members were requested to send their comments on the draft document to the Chairman after the meeting for consideration.

KP reported that, upon receipt of the Task Force's comments, he would amend the document to take into account Task Force's views and input. He would also hold further meetings with Task Force Members and/or the Report Editor, if necessary, to review and further edit the document before circulating it to the Com-PCM for comment.

2.8 Report of the Task Force on Employer-Procured Insurance Policies in Construction Contracts

Chairman of the Task Force on Employer-Procured Insurance Policies in Construction Contracts, SGN, briefed Members on the progress of the Task Force.

Members were advised that, at the last meeting of the Task

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Force held on 5 June 2013, Task Force Members explored the potential benefits and pitfalls of the use of employer-procured insurance policies in Hong Kong. Task Force Members also shared a range of local and overseas experience in the application of employer-procured insurance and discussed briefly on the difference between employer-procured insurance policies and contractor-controlled insurance policies.

SGN reported that, at the upcoming meetings, the Task Force would continue the sharing of experience on the use of employer-procured insurance policies in construction contracts and start to deliberate on the possible deliverables and way forward of the Task Force.

2.9 Year Plan for 2013/2014 – Progress Review

AL introduced the Paper CIC/PCM/P/014/13 regarding the progress review as well as updating of the Year Plan 2013-2014 for the Com-PCM. Members noted and confirmed the Year Plan.

2.10 Any Other Business

In response to the concerns raised by a Member regarding the practice being adopted by a sub-vented organisation overseen by the Architectural Services Department in requesting the consultants to include the costs of Resident Site Staff into the lump sum fee proposal for consultancy services, KLo stated that he would bring back the matter to the relevant government officials for their attention.

Chairman announced that AL would be joining the Training and Development Section of the CIC with effect from 1 July 2013 and that his duties on Council Services would be taken up by another Senior Manager, Mr. Ivan WONG, from 1 July 2013 until further notice. *(Post-meeting note: AL's duties on Council Services would be taken up by the Executive Director, Mr. Christopher TO, from 1 July 2013 until further notice.)*

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2.11 Date of Next Meeting

Monday, 23 September 2013 at 2:30pm at Meeting Room 1, **All to note**
CIC Headquarters, 15/F Allied Kajima Building, Wanchai,
Hong Kong.

There being no further business, the meeting adjourned at 5:00pm.

CIC Secretariat
June 2013