

**Construction Industry Council**

**6<sup>th</sup> Progress Report of Committee on Subcontracting**

**Purpose**

This paper outlines the main points discussed at the 6<sup>th</sup> meeting of the Committee on Subcontracting held on 17 September 2008. The record of attendance is at Annex A.

**Items Discussed**

2. Members discussed the following items –
  - the proposal for taking over the operations of the Voluntary Subcontractor Registration Scheme (VSRS) from Hong Kong Construction Association and phasing out PCICB Registration Limited;
  - security of payment – assessing the nature and extent of the problem;
  - findings of the survey on the register of subcontractors (Stage 2 of the VSRS);
  - update on the work plan; and
  - Enhanced Ethical Status for subcontractors registered on the VSRS.

**Progress on Matters Arising from the 5<sup>th</sup> Meeting on 14 July 2008**

3. Members noted the following –
  - (a) paragraphs 24(a) to (f) – the matters would be discussed in latter parts of the meeting; and
  - (b) paragraph 24(g) – the Guidelines on Administration Charges for Reporting of Site Accident was endorsed by CIC for promulgation at the 11<sup>th</sup> meeting held on 28 August 2008. The CIC Secretariat would organise promulgation accordingly. The usage of the Guidelines would be reviewed in the first quarter of 2009.

**Proposal for Taking Over the Operations of VSRS from Hong Kong Construction Association (HKCA) and Phasing Out PCICB Registration Limited (PRL)**

4. Members noted that the CIC Secretariat had an initial proposal on taking over the operations of the VSRS as follows:

- (a) Initial phase
  - HKCA to remain as the Scheme Operator for another 6 months
  - The CIC Secretariat to take over from the Development Bureau the secretarial services for the Management Committee of the VSRS
  - CIC to be the Scheme Owner by 1 January 2009 and PRL to be closed accordingly
  
- (b) Final phase
  - The CIC Secretariat to perform the role of Scheme Operator
  - Additional staff to be in place to administer the VSRS
  - A new computer system to be developed to improve operational efficiency and to cater for Stage 2 of the VSRS
  - A suitable location to be identified for accommodating the VSRS office
  - The operational process to be reviewed with a view to streamlining relevant procedures

5. Members also noted that HKCA had proposed not to renew the current service agreement after 25 November 2008 considering its constraints on internal resources. However, the Chairman cautioned that there would be insufficient time for the CIC Secretariat to familiar with the operations by 25 November 2008. To minimize operational risks, HKCA was advised to consider continuing its obligation to ensure the smooth running of the VSRS.

6. A Member advised the CIC Secretariat to explore whether the existence of PRL would be helpful to screen off unnecessary liability before proceeding to wind up PRL.

7. The Committee agreed to adopt the proposal on taking over the operations of the VSRS as described in paragraph 4 subject to –

- (a) further discussion with HKCA on the renewal of the current service agreement; and

- (b) endorsement on resources deployment by the Committee on Administration and Finance.

*[Post-meeting note: HKCA has agreed to renew the current service agreement for another six months until 25 May 2009. The Committee on Finance and Administration has approved the recruitment of a manager and three clerical staff for the operations of the VSRS.]*

### **Security of Payment – Assessing the Nature and Extent of the Problem**

Survey Findings on General Building Contractors' and Specialist Contractors' Status on Cash Flow and Other Related Issues (Survey on Contractors) by Hong Kong Construction Association (HKCA)

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*[Mr Thomas Tse of HKCA together with Dr Robert Chung, Ms Karie Pang and Ms Winnie Lee of HKU joined the meeting at this juncture.]*

8. HKCA commissioned the Public Opinion Programme at the University of Hong Kong (HKU) to conduct the Survey on Contractors to reveal cash flow problems faced by contractors. Target respondents included members of HKCA and The Hong Kong Federation of Electrical and Mechanical Contractors Limited. Members received a presentation from Dr Robert Chung and major findings were summarized as below –

- (a) Inflation and high cost of materials was a major problem facing contractors. Another critical problem was outstanding payments from the other contracting parties.
- (b) “Variations under assessment” was the main reason for payment in disagreement with the other contracting parties.
- (c) The mean percentage of overall payment withheld due to disagreement/dispute with employers or other contract parties over the past 12 months was 10% of the original contract sum.
- (d) “Insufficiency of cash flow” was not considered as a serious problem by contractors while the severity of “Outstanding payment to subcontractors” was even lower.

*[Mr K H Tao left the meeting at 4:00 pm.]*

9. Dr Chung added that the survey results were worked out from the number of respondents only without taking account of the respective market shares.

*[Mr Thomas Tse, Dr Robert Chung, Ms Karie Pang and Ms Winnie Lee left the meeting after the presentation.]*

10. Members acknowledged that the problems of outstanding payment from the other contracting parties and payments withheld due to disputes would deserve further study.

#### Survey on Cash Flow Problems in the Construction Supply Chain

11. The Survey on Contractors reflected that the main contractors suffered from outstanding payments. Members wondered why the situation neither transmitted into cash flow problems nor impacted on downstream subcontractors. However, the Survey on Contractors did not probe into the issues due to limited resources allocated by HKCA.

12. Members considered obtaining a complete picture of the problems encountered by other parts of the supply chain through a comprehensive survey was necessary. As for the survey methodology, it should be based on the questionnaires for the HKCA survey with modifications to address the different positions of developers, consultants, subcontractors and suppliers. The findings of the proposed survey should be analyzed jointly with the findings of Survey on Contractors to come up with an overall picture relating to cash flow and outstanding payment issues in the industry. As such, Members agreed to commission a comprehensive survey with a view to analyzing the problem of security of payment in the industry and considering the necessity and appropriateness of resolving the problem through legislation

13. To obtain funding for the proposed survey, the CIC Secretariat would make a submission to the Committee on Administration and Finance for consideration.

*[Post-meeting note: The Committee on Administration and Finance at its meeting of 26 September 2008 agreed that the funding request be considered directly by CIC.]*

#### Escrow Accounts for Retention Money

14. Members noted the discussion at the CIC meeting held on 28 August 2008 regarding the legal viability for CIC to manage escrow accounts and agreed the CIC Secretariat to seek legal advice on the issue and report the result to the Committee at the next meeting.

## **Findings of Survey on the Register of Subcontractors (Stage 2 of the VSRS)**

15. The proposed structure and key parameters for the Register of Subcontractors were found to be affirmative according to the survey findings. An overwhelming majority of the respondents indicated their support for the 3-grade register and the adoption of the existing trade classification for the proposed register. As for setting financial limits on the value of individual subcontracts undertaken by subcontractors of the entry grade and the intermediate grade, majority of the respondents supported the proposal.

16. Members agreed that proper consultation with subcontractors would be necessary as to setting the entry requirements and the financial limits for each grade. With Mr TSE Chun-yuen as the leader and the assistance of Mr Lawrence NG, the CIC Secretariat would work with Mr TSE and Mr NG to form a working group to recommend a suitable structure. A Member suggested the working group to consider setting compliance with safety standards as one of the entry requirements and formulating a re-grading mechanism within the register.

## **Update on Work Plan**

17. Members noted the updated work plan. The CIC Secretariat was asked to separate “Guidelines on Measures for Protection of Workers’ Entitlement to Wage Payment” as an individual item while other possible solutions to address the problem of security of payment could be further investigated in the discussion of “Security of Payment”. It was envisaged that the latter would take longer time.

*[Post-meeting note: A revised work plan is at Annex B.]*

## **Enhanced Ethical Status (EES) for Subcontractors Registered on the VSRS**

18. It was reported that an informal meeting was held on 4 August 2008 to discuss the revised Rules and Procedures of the Primary Register for the purpose of introducing EES in the VSRS. They had also touched on the feasibility of making use of an independent list instead of the VSRS because ICAC only aimed to assist Owners’ Corporations in identify ethical contractors for building maintenance works but not all subcontractors.

19. In response to Members’ request for clarifying whether the Committee had confirmed to support using the VSRS as a platform for introducing the EES, the CIC Secretariat was requested to circulate to Members the relevant meeting record for further perusal.

*[Post-meeting note: Extracts from the meeting records of the following meetings (Annex C) were circulated to Members by an email on 25 September 2008:*

- the 4<sup>th</sup> Progress Report and the 5<sup>th</sup> Progress Report of the Committee*
- the 9<sup>th</sup> Meeting of Construction Industry Council*
- the informal meeting held on 4 Aug 2008 ]*

20. As to the definition of “collusion”, Members agreed to adopt the definition stipulated in the tender documents of the Housing Department.

21. ICAC confirmed that they would not insist on including the requirement to revoke the registration status of a subcontractor involved in misconduct before conviction.

22. In view of the ICAC’s latest position and the consensus on the definition of “collusion”, the CIC Secretariat was directed to further study the introduction of the EES in the VSRS to facilitate Members’ discussion at the next meeting.

### **Further Actions**

23. The following further actions were agreed –

- (a) the CIC Secretariat would further discuss with HKCA on the renewal of service agreement regarding the operations of the VSRS;
- (b) the CIC Secretariat would seek endorsement from the Committee on Administration and Finance on resources deployment for taking over the operations of the VSRS;
- (c) the CIC Secretariat would seek legal advice on whether the existence of PRL would be helpful to screen off unnecessary liability;
- (d) the CIC Secretariat would solicit funding support from CIC to commission the comprehensive survey on problems of cash flow and outstanding payments in the construction supply chain;
- (e) the CIC Secretariat would seek legal advice on the legality of managing escrow accounts for retention money by CIC;

- (f) a working group would be formed to advise on entry requirements and financial limits to be applied on each grade of the Register of Subcontractors under Stage 2 of the VSRS; and
- (g) the Secretariat would circulate again the relevant minutes and progress reports on the discussion of introducing EES for subcontractors registered on the VSRS and would prepare a paper to facilitate Members' discussion at the next meeting.

**CIC Secretariat  
September 2008**

**Committee on Subcontracting**

**6<sup>th</sup> Meeting held at 2:30 pm on 17 September 2008  
in Conference Room 1201, Murray Building**

**Record of Attendance**

**Present**

Mr S S LEE	Chairman
Ms Teresa CHENG	
Mr CHEUNG Tat-tong	
Mr James CHIU	
Mr TSE Chun-yuen	
Mr Conrad WONG	
Mr Bernard HUI	The Hong Kong Institute of Architects
Mr Lawrence NG	Hong Kong Marble and Granite Merchants Association
Mr LAW Wai-tai	Hsin Chong Construction Co. Ltd.
Mr C S SO	Henderson Land Development Co. Ltd.
Mr WONG Sing-lam	Contractor's Authorized Signatory Association
Mr LAM Siu-tong	Buildings Department
Ms Sonia YUNG	Housing Department
Mr T F LEUNG	Development Bureau
Mr S H TSO	Labour Department
Mr W H MOK	Independent Commission Against Corruption

**Apologies**

Mr Thomas CHAN	Permanent Secretary for Transport and Housing (Housing)
Mr CHOI Chun-wa	
Mr Stanley HUI	
Ir Edgar KWAN	
Mr WAN Koon-sun	
Mr YU Wai-wai	
Mr Paul CHONG	The Hong Kong Federation of Electrical and Mechanical Contractors
Mr LAI Chi-hung	Hong Kong Construction Industry Employees' General Union
Mr CHEUNG Tak-hing	Construction Site Workers General Union
Mr YAU Hung-yuen	Association of Electrical Contractors
Mr Joseph NG	Hong Kong General Building Contractors Association



**In Attendance**

**CIC Secretariat**

Mr Christopher TO	Executive Director
Mr Ivan WONG	Senior Manager (Council Services) 2
Ms Phoebe LEUNG	Manager (Council Services) 2

**Development Bureau**

Mr K H TAO	Chief Assistant Secretary for Development (Works) 1
Mr Rico CHEUNG	Assistant Secretary for Development (Works) Policy and Development 3

**For discussion on “Survey on Contractors” only**

Mr Thomas TSE	Hong Kong Construction Association
Dr Robert CHUNG	)
Ms Karie PANG	) The University of Hong Kong
Ms Winnie LEE	)

**Work Plan****(I) Stage 2 of VSRS**

<b>Schedule</b>	<b>Task</b>
Nov 2008	Formulation of detailed proposal for structure of Register of Subcontractors
	Consideration of structure by Committee
Dec 2008	Drafting operational framework for the Register of Subcontractors
Jan 2009	Consideration of operational framework by Committee
Feb 2009	Endorsement of release of operational framework for industry consultation by CIC
Mar – May 2009	Industry consultation on operational framework
Jun 2009	Revision of operational feedback taking into account industry feedback
Jul 2009	Consideration of revised operational framework by Committee
Aug 2009	Endorsement of revised operational framework by CIC
Sep – Nov 2009	Implementation of Register of Subcontractors
Dec 2009	Launch of Register of Subcontractors

**(II) Improvements to VSRS**

<b>Schedule</b>	<b>Task</b>
Jan – Mar 2009	Drawing up proposals for value-added services
Apr 2009	Consideration of proposal by Committee
Jun 2009	Launch of value-added services upon CIC taking over the role of Scheme Operator

**(III) Security of Payment**

<b>Schedule</b>	<b>Task</b>
Nov 2008 – Mar 2009	Conducting survey on cash flow problems of different parties in the construction supply chain
Apr 2009	Assessing the nature and extent of the security of payment problem
Jun 2009	Based on the nature and extent of the problem identified, developing draft guidelines on security payment problem for consultation
Oct 2009	Examining the justification for security of payment legislation with reference to the results of consultation
Early 2010	Formulating the framework for the legislation (if security of payment legislation was justified)

**(IV) Guidelines on Administration Charges for Reporting of Site Accidents**

<b>Schedule</b>	<b>Task</b>
Nov 2008	Distribution of guidelines
Mar 2009	Review of the usage of guidelines

**(V) Guidelines on Measures for Protection of Workers' Entitlement to Wage Payment**

<b>Schedule</b>	<b>Task</b>
Jan 2009	Endorsement of guidelines by Committee
Feb 2009	Approval of guidelines by CIC for promulgation

**CIC Secretariat  
September 2008**

<b>Date</b>	<b>Meeting</b>	<b>Extract from Progress Report / Minutes</b>
7 April 2008	4 <sup>th</sup> meeting of Committee on Subcontracting	<p>11. <a href="#"><u>ICAC proposed to use the VSRS as one of the platforms for achieving this objective by introducing the Enhanced Ethical Commitment Scheme (EECS)</u></a> whereby Registered Subcontractors not having been subject to any regulatory actions under clause 10 of the Rules and Procedures of the Primary Register could apply to join the EECS by promulgating an enhanced company code on ethic (in addition to issuing the company policy on ethics under clause 19 of the Rules and Procedures) pledging not to collude with other parties in the bidding and implementation of any construction contracts and to declare any actual or potential conflict of interest in bidding and executing construction works.</p> <p>12. To assure the credibility of the EECS, the Management Committee could revoke EECS status of a Registered Subcontractor under specified circumstances including any regulatory actions being taken against the Registered Subcontractors, its failure to comply with the enhanced company code on ethics, conviction of its senior staff for criminal offences involving corruption or fraud, embezzlement and theft in connection with construction works, availability of substantial evidence of such misconduct or winding up or bankruptcy of the company.</p> <p>13. <a href="#"><u>Members supported the proposal in principle but were concerned about the possibility that EECS status being revoked for corruption offences before actual convictions.</u></a> The Secretariat was directed to give careful consideration to this aspect in revising the Rules and Procedures for implementing the scheme and circulate the draft to Members for comments.</p>

<b>Date</b>	<b>Meeting</b>	<b>Extract from Progress Report / Minutes</b>
2 May 2008	9 <sup>th</sup> meeting of CIC	14. The 4th meeting of the Committee was held on 7 April 2008 to discuss the security of payment, <a href="#">proposal for enhanced ethical commitment by subcontractors registered on Voluntary Subcontractor Registration Scheme (VSRS)</a> , Stage 2 of VSRS, administration charges for accident report as well as measures to control and monitor payment of wages to workers engaged in public housing contracts.
14 July 2008	5 <sup>th</sup> meeting of Committee on Subcontracting	21. Members considered the proposed changes made to the Rules and Procedures of the Primary Register (Rules and Procedures) to facilitate <a href="#">the introduction of EES that aimed to make use the VSRS as one of the platforms</a> for assisting building owners and Owners' Corporation in identifying contractors committed to ethical practices to bid for building maintenance contracts. These included procedures for applying for EES and procedures for revocation of EES for any regulatory actions being taken against the Registered Subcontractor in accordance with the Rules and Procedures; corruption, fraud, embezzlement or theft in connection with construction projects committed by senior management staff (e.g. proprietors, partners or directors) <a href="#">as evinced by convictions or other convincing evidence</a> ; or winding-up or bankruptcy of the company.  22. Noting that Registered Subcontractors applying for EES had to pledge not to collude with other parties in bidding and executing any construction contracts, the <a href="#">Secretariat was directed to arrange for further discussions to work out a clear definition for "collusion" before the revised Rules and Procedures were further considered by the Committee.</a>

<b>Date</b>	<b>Meeting</b>	<b>Extract from Progress Report / Minutes</b>
4 Aug 2008	Informal meeting	<p>An informal meeting was held to discuss the “collusion” issue amongst:</p> <ul style="list-style-type: none"><li>• Mr TSE Chun-yuen</li><li>• Mr Conrad Wong</li><li>• Mr Lawrence Ng</li><li>• Mr MOK Wah-hoi / Alpha Leung (ICAC)</li><li>• CIC Secretariat (K H Tao / Alex Leung)</li></ul> <p>A proposal was made by creating an independent list of registration for the EES based on BD’s contactor list so as to confine the application of collusion to building contractors only to fulfill the need of ICAC.</p>