

Construction Industry Council
5th Progress Report of Committee on Subcontracting

Purpose

This paper outlines the main points discussed at the 5th meeting of the Committee on Subcontracting held on 14 July 2008. The record of attendance is at Annex A.

Items Discussed

2. Members discussed the following items –
- ways to ensure fair and prompt payment;
 - work plan for security of payment;
 - taking over of operations of the Voluntary Subcontractor Registration Scheme (VSRS) by CIC staff;
 - questionnaire survey on structure of Register of Subcontractors;
 - Enhanced Ethical Status (EES) for subcontractors registered on the VSRS; and
 - Guidelines on Administration Charges for Accident Reporting

Progress on Matters Arising from 4th Meeting on 7 April 2008

3. Members noted the following –
- (a) paragraph 23(a) to (d) – the matters recorded in these paragraphs would be discussed in latter parts of the meeting;
 - (b) paragraph 23 (e) – the training courses for Labour Relation Officers had been approved by the Construction Industry Training Board and would be launched in October 2008; and

- (c) paragraph 23(f) – the work plan of the Committee had been submitted to the 9th CIC meeting held on 2 May 2008.

Ways to Ensure Fair and Prompt Payment

4. Ms Teresa Cheng gave an overview of the measures for enhancing security of payment including use of properly written subcontracts; payment bond; escrow account for retention; and statutory adjudication. On written subcontracts, while construction payment could not be secured without properly and clearly written contract, many subcontractors in Hong Kong did not enter into formal subcontracts with subcontractors in upper tiers. As such, efforts should be made to promote use of properly written subcontracts to achieve better protection of the rights of the contracting parties.

5. A payment bond was an agreement by a surety towards a contractor that the surety would pay to the contractor the amount of the works done under a construction contract up to the bonded amount if the employer defaults in payment obligations. Payment bonds could be justified by the fact that construction contracts involved certain forms of advanced funding by contractors and subcontractors. In the Hong Kong context, payment bonds were also required for protecting contractors who had to enter into construction contracts with shell companies formed by their parent companies as shields against unwanted liabilities.

6. The lack of contractual or statutory provisions for holding retention money in separate accounts had led to cases of delay in payment and non-payment. If Hong Kong was to introduce the statutory requirements in other jurisdictions such as New Mexico for holding retention money in separate escrow accounts, CIC could be in a position to provide such service at a reasonable fee.

7. Statutory adjudication for making expeditious decisions on payment disputes was the key feature of security of payment legislation in other jurisdictions and appeared to be operating without much dissatisfaction and complaints and could provide a workaround to the common contractual provisions that arbitrations could only be conducted after substantial completion. As the timeframe for statutory adjudications was relatively short, the parties were usually given the right to re-open the decisions thus reached in arbitrations conducted after the completion of the works.

8. Most of the Members supported enactment of security of payment legislation in principle on the grounds of ensuring that cash could flow through the multi-layered construction supply chain so that workers could receive timely wage payments. On the other hand, some Members doubted the need for legislation arguing that the problem of wage arrears could be contained by encouraging workers to be more vigilant in enforcing their statutory rights. Members generally supported the adoption of mandatory adjudication or similar measures for seeking expeditious decisions to payment disputes. Some Members had reservation on the adoption of escrow accounts for retention money which could increase working capital requirements.

9. Private sector clients would tend to make substantial deductions to certified payments for various reasons in particular upon detecting any delays to the executive of the works. This practice could result in payment problems if contractors and their subcontractors were not advised of the specific reasons for making deductions. There were also concerns on the cash flow problems resulting from delays in valuing major variations which were common in private sector contracts because of the need to respond to changes in market conditions. As a related issue, the large number of verbal instructions not confirmed expeditiously in writing could also result in payment problems. A substantial proportion of payment disputes could also result from contractors being forced to absorb the financial consequences of mistakes made by clients and consultants.

10. In conclusion, Members agreed that CIC should take the lead in finding solutions to the payment problems in the construction industry.

Work Plan for Security of Payment

11. Members endorsed the work plan on security of payment consisting of four parts –

- (a) developing CIC guidelines on security of payment;
- (b) assessing the nature and extent of the security of payment problem;
- (c) examining of the justification for security of payment legislation; and

- (d) if security of payment legislation was justified, formulating the framework for the legislation.

12. The guidelines on security of payment would be developed on the basis of the agreed outline at Annex B with a view to releasing the draft version for industry consultation late 2008/early 2009. In parallel with this, HKCA was conducting a survey on its members and members of HKFEMC on the extent of the security of payment problem and would submit the findings to the Committee. Members agreed that a similar survey should be conducted by CIC on the other parts of the supply chain including developers and subcontractors for completion by early 2009 to enable the Committee to start examining the justification for security of payment legislation. The Secretariat would develop a proposal for the survey for seeking research funding from the Committee on Environment and Technology. If security of payment legislation was justified, the Committee would start formulating its legal framework for industry consultation by late 2009.

Taking Over of Operation of VSRS by CIC Staff

13. HKCA advised CIC through its letter of 5 June 2008 that the association would wish to hand back the frontline operations of the VSRS to CIC upon the expiry of the current service agreement on 25 November 2008. The Secretariat would devise a work plan for taking over the frontline operations covering accommodation for the Registration Office, recruitment of additional CIC staff for the frontline operations and computer application for supporting the operation of the VSRS.

14. Members supported the taking over the frontline operations from HKCA since the service agreements were intended to tide over the lack of staff resources by the former PCICB and it was envisaged at the outset that CIC would take over from HKCA upon its formation. HKCA also agreed to consider extending the current service agreement by six months to facilitate a smoother transition.

15. The budget and the employment of new staff for taking over the frontline operations would be submitted to the Committee on Administration and Finance for consideration in due course.

16. Given that the former PCICB was not an independent legal entity, the PCICB Registration Limited (PRL) was formed in 2003 as a vehicle for operating the VSRS. On the other hand, CIC being a statutory organization could operate the VSRS directly. As such, Members agreed

that PRL should be gradually phased out subject to devising suitable transitional arrangements.

17. It was planned for the CIC staff to gradually take over the following administrative duties undertaken currently by DEVB in its capacity as the temporary secretariat for CIC, commencing in July 2008: –

- (a) providing secretarial support to the Management Committee;
- (b) circulating recommendations of the Scheme Operator to the Management Committee;
- (c) handling requests for review of decisions of the Management Committee;
- (d) providing support to regulatory proceedings;
- (e) updating the Rules and Procedures for the Primary Register; and
- (f) housekeeping of PCICB Registration Limited (for example arranging for preparation of audited accounts).

Questionnaire Survey on Register of Subcontractors

18. Members endorsed the questionnaire for conducting a survey on contractors and subcontractors to collect feedback on the proposed structure and various key parameters for the Register of Subcontractors which would be launched in Stage 2 of the VSRS subject to the following changes –

- (a) adding a note to the questionnaire indicating that the explanation for the terms used in the questionnaire could be found in the covering letter; and
- (b) Question 4 – to be re-phrased to ask for the respondent's view on not setting any limit on the value of subcontract that could be undertaken by Registered Subcontractors on the highest grade.

19. Members also agreed that the questionnaire should be distributed to the following types of organizations –

- (a) the trade associations for contractors and subcontractors listed in Part 3 of Schedule 2 of the CIC Ordinance and other interested industry organizations;
- (b) contractors on approved lists of DEVB;
- (c) contractors on approved lists of HD;
- (d) Registered General Building Contractors;
- (e) Registered Specialist Contractors; and
- (f) subcontractors registered on Voluntary Subcontractor Registration Scheme.

20. The CIC Secretariat would conduct the questionnaire survey and report the findings in due course.

EES for Subcontractors Registered on the VSRS

21. Members considered the proposed changes made to the Rules and Procedures of the Primary Register (Rules and Procedures) to facilitate the introduction of EES that aimed to make use the VSRS as one of the platforms 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) as evinced by convictions or other convincing evidence; 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 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.

Guidelines on Administration Charges for Accident Reporting

23. Members endorsed the Guidelines on Administration Charges for Accident Report for submission to CIC for further endorsement for promulgation.

Further Actions

24. The following further actions were agreed –
- (a) The Secretariat would prepare the Guidelines on Security of Payment for discussion at future meetings;
 - (b) HKCA would complete a survey on its members and members of HKFEMC on the extent of the security of payment problem and submit the findings to the Committee;
 - (c) The Secretariat would develop a proposal for conducting a similar survey on the other parts of the supply chain for seeking research funding from the Committee on Environment and Technology;
 - (d) The Secretariat would develop a plan for taking over the frontline operation of the VSRS from HKCA and discuss with HKCA the possibility of extending the current service agreement by six months;
 - (e) The Secretariat would devise suitable transition arrangement for phasing out PCICB Registration Limited for consideration by the Committee;
 - (f) The Secretariat would conduct the questionnaire survey on the Register of Subcontractors and report the findings in due course;
 - (g) The Secretariat would arrange for further discussions with interested Members on the revisions to the Rules and Procedures for implementing the EES; and

- (h) The Secretariat would submit the Guidelines on Administration Charges for Accident to CIC for endorsement for promulgation.

CIC Secretariat
August 2008

Committee on Subcontracting

**5th Meeting held at 2:30 pm on 14 July 2008
in Conference Room 1201, Murray Building**

Record of Attendance

Present

Mr S S Lee	Chairman
Mr CHOI Chun-wa	
Mr CHEUNG Tat-tong	
Mr James Chiu	
Ir Edgar Kwan	
Ms Teresa Cheng	
Mr TSE Chun-yuen	
Mr WAN Koon-sun	
Mr Conrad Wong	
Mr YU Wai-wai	
Mr N M Chan	Representing Permanent Secretary for Transport and Housing (Housing)
Mr Bernard Hui	Hong Kong Institute of Architects
Mr NG Koon-kwan	Hong Kong Construction Site Workers General Union
Mr Lawrence Ng	Hong Kong Marble and Granite Merchants Association
Mr C S So	Henderson Land Development Co. Ltd
Mr WONG Sing-lam	Contractor's Authorized Signatory Association
Mr S H Tso	Labour Department
Mr MOK Wah-hoi	Independent Commission Against Corruption
Mr LAM Siu-tong	Buildings Department
Mr Joseph Yung	Development Bureau
Mr David Tong	Development Bureau
Mr YAU Hung-yuen	Association of Electrical Contractors

Absent with Apologies

Mr Stanley Hui

Mr Paul Chong	Hong Kong Federation of Electrical and Mechanical Contractors
Mr LAI Chi-hung	Hong Kong & Kowloon Painters General Union
Mr LAW Wai-tai	Hong Kong Construction Association
Mr Joseph Ng	Hong Kong General Building Contractors Association
Ms Sonia Yung	Housing Department

In Attendance

Development Bureau

Mr K K Yeung	Principal Assistant Secretary for Development (Works)1
Mr K H Tao	Chief Assistant Secretary for Development (Works)1
Mr Solomon Wong	Assistant Secretary for Development (Works) Policy and Development 3

CIC Secretariat

Mr Christopher To	Executive Director (Designate)
Mr Charles Wong	Acting Executive Director
Mr Alex Leung	Senior Manager (Council Services)1
Ms Claudia Au	Manager (Council Services)1

Outline of CIC Guidelines of Security of Payment

1. Introduction
2. Payment problems affecting the construction supply chain
 - (a) adoption of inequitable contract terms in main contracts
 - (b) adoption of “pay when paid” provisions in subcontracts
 - (c) delays in valuation of variations
 - (d) deductions made to certified payments
3. Measures for enhancing security of payment
 - (a) adoption of proper written construction contracts with equitable contract terms
 - (b) adjudication before the completion of the works
 - (c) milestone payment
 - (d) payment bonds to be taken out by client organizations
 - (e) escrow account for retention money
 - (f) specifying reasons for making deductions from payments
4. Further development on security of payment