

Insights

CHANGES IN THE PAYMENT AND ADJUDICATION PROCESSES REGARDING VARIATIONS AND TIME-RELATED DISPUTES

CONSTRUCTION INDUSTRY SECURITY OF PAYMENT BILL 2024

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SUMMARY

In May 2024, the Hong Kong Government introduced the Construction Industry Security of Payment Bill (**Bill**) to the Legislative Council for first reading. If the Bill is passed into law, the Bill will introduce a statutory security of payment regime for both public sector and private sector construction contracts in Hong Kong.

This is the second article in a series of two articles. In the earlier article, we compared the clauses in the Bill against the public works contracts pilot programme security of payment provisions (**Pilot Provisions**) promulgated by the Development Bureau (**DevB**) in its Technical Circular (Works) No.6/2021 (**Circular**) for the contractual regime, and considered the key development, changes and differences.

In this article, we will take a deeper look at the changes made in the Bill concerning the treatment of variation claims and time-related disputes in the payment process and the adjudication process.

There are two aspects of the payment process and the adjudication process in the security of payment regime that have been subject of much debate. These two aspects concern how variation claims and time-related disputes are dealt with under the statutory security of payment regime. The two aspects are:

- The claim handling procedure (Clause 9 of the Pilot Provisions; Clause 23 of the Bill).
- Whether and what jurisdiction the adjudicator should have in respect of time-related disputes (Clause 17 of the Pilot Provisions; Clauses 33, 42 and 56 of the Bill).

We will consider these two issues in turn.

CONTRACTUAL CLAIM HANDLING PROCEDURE

(Clause 9 of the Pilot Provisions; Clause 23 of the Bill)

Under the contractual security of payment regime, clause 9 of the Pilot Provisions provides adjudication as the mandatory, interim mechanism for the resolution of payment disputes. There is, however, one notable carve-out: parties first will have to go through the claim handling procedure stipulated in the contract, before adjudication proceedings may be commenced in respect of a claim for additional payment.

While this feature has found itself into the Bill, some changes and clarifications have been made:

SCOPE OF THE CARVE-OUT - MEANING OF “CLAIM FOR ADDITIONAL PAYMENT”

In clause 9 of the Pilot Provisions, a claim for additional payment is defined with reference to the happening of a compensable event specified in the construction contract.

Further clarity is provided in the Bill. Clause 23(5) of the Bill defines a claim for additional payment, in brief terms, as: (a) a claim for payment provided for in a construction contract for expenditure or loss incurred because of delay or disruption, or (b) variation to the construction work.

THE RELATIONSHIP WITH THE PAYMENT CLAIM AND THE COMMENCEMENT OF ADJUDICATION PROCEEDINGS

Another notable change is the introduction of the requirement for the parties to have gone through the contractual claim handling procedure **before** the date on which the Payment Claim is served, as opposed to before adjudication proceedings could be commenced.

Clause 9(3) of the Pilot Provisions state as follows:

“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 construction contract], does not arise unless and until the [contract administrator] has notified [contractor] of his rejection and / or assessment of such claim or has failed to notify the [contractor] of his 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.”

In contrast, Clause 23(4) of the Bill states as follows:

*“Despite subsection (1), if a construction contract provides for a claim handling procedure for a claim for any additional payment, a payment dispute does not arise to the extent that it relates to the additional payment unless any of following events occurs **before the payment claim for the additional payment is served under section 18** –*

- a. *an assessment on the additional payment has been made in accordance with the claim handling procedure;*
- b. *an assessment on the additional payment has not been made in accordance with the claim handling procedure—*
 - i. *if the claim handling procedure provides for a period within which the assessment is to be made—within the period;*
 - ii. *otherwise—within a reasonable period.”*

(Emphasis added)

Under the formulation in the Pilot Provisions, there is no requirement for the claim handling procedure to have been or deemed to have been gone through before a claiming party could include a claim for additional payment in the Payment Claim.

As a matter of legal theory, a claiming party may include a claim for additional payment in a Payment Claim, wait for the contractor administrator to notify his assessment or the passage of the relevant time for the contractor administrator to do so, and then commence adjudication proceedings in respect for the claim for additional payment – immediately, and without serving another Payment Claim.

By contrast, under the formulation in the Bill, the contract administrator will have to have decided on a variation claim or a time-related claim **before** the claiming party could include such a claim in the Payment Claim as “*served under section 18*” (see emphasis above). Otherwise, a payment dispute will not arise in respect of such a claim.

In practice, the above change will have the effect of deferring payment disputes in respect of a variation claim or a time-related claim to the next payment cycle (i.e. the payment cycle following the contractor administrator’s notification of his assessment on the variation claim or time-related claim or the passage of the relevant time for the contractor administrator to do so). This change might have a negative impact on how payments flow down the sub-contracting chain, and the precise impact to a large extent would depend on the frequency of payment cycle at each tier of sub-contracting.

ISSUE SPECIFIC TO THE “REASONABLE TIME” ROUTE

Where the contract does not provide for a period within which the contract administrator is to notify his assessment, the parties will face the question of whether reasonable time has passed for the contract administrator to do so. Lawyers seem to delight in arguing – and disagreeing – about what is a reasonable time.

Under the formulation in the Pilot Provisions, the question of whether reasonable time has passed is a question that only will arise at the stage the claiming party is considering whether to commence adjudication proceedings in respect of a variation or time-related claim for which no assessment has been notified by the contract administrator.

Under the formulation in the Bill, the question of whether reasonable time has passed will arise at an earlier stage - at the time the claiming party is preparing and serving the Payment Claim.

Further, if the adjudicator takes the view that reasonable time has not passed by the time the Payment Claim was served, under the formulation in the Bill, the adjudicator might take the view that he has no choice but to rule that a payment dispute has not arisen in respect of the variation or time-related claim in question, and to dismiss the claim on the basis that he has no jurisdiction over the matter. The paying party would then have to try its luck in the next payment cycle.

In contrast, under the formulation in the Pilot Provisions, if the (non)paying party raises an objection to the adjudicator that a reasonable time has not passed in accordance with the claim handling procedure, in theory, the time spent by the adjudicator and the parties considering this objection in fact **counts towards** the passage of "reasonable time".

According to the [Legislative Council Brief on the Bill](#), this feature that parties are required to go through the claim handling procedures under the contract before adjudication is a feature of the Singapore regime, but not a feature of other overseas jurisdictions compared in the Legislative Council Brief – such as the United Kingdom, New Zealand, or Malaysia. The rationale for adopting this requirement in Hong Kong is that claim handling procedures: (1) prevent pre-mature referral of payment dispute in relation to claims for additional payment to adjudication – such as prolongation cost or variation orders; and (2) prevent ambush, in particular for complex claims.

The Legislative Council Brief raised that some local industry stakeholders have expressed concern on the "*potential implications on those professionals taking up the role of contract administrators*". This is understandable – as pointed out in the [Adjudication Handbook for Security of Payment Provisions](#), jointly published by the Society of Construction Law (HK) and the University of Hong Kong Department of Real Estate and Construction, the requirement that payment disputes can progress to adjudication only after the claims have been assessed under the claim handling procedures under the contract (1) will add a layer of time and cost, and (2) will run the risk of third parties (e.g. professional contract administrators) slowing down or even interfering with the resolution of the payment dispute.

It remains to be seen how claim handling procedures will affect adjudication in practice. In the [first and second readings of the Bill on 29 May 2024 in the Legislative Council](#), the administration indicated that a code of practice may be formulated for adjudicators to take into account professional assessments of contract administrators, such as engineers, architects or surveyors, in

the evaluation of the payment grounds put forth by the parties. Taking a look at the claim handling procedures under common forms of contracts such as NEC3, NEC4 and GCC for Civil Engineering Works, E&M Engineering Works or Building Works (1999 Edition), contract administrators may involve the Engineer, Surveyor, Supervising Officer, Service Manager, or Project Manager – as defined under those respective contracts (see the [Adjudication Handbook for Security of Payment Provisions](#) above).

THE ADJUDICATOR’S POWER TO DECIDE TIME-RELATED DISPUTES

(Clause 17 of the Pilot Provisions; Clauses 33, 42 and 56 of the Bill)

Whether the adjudicator should be given the power to decide on claims for extension of time and time-related costs has been a matter of much debate.

According to the [Legislative Council Brief on the Bill](#), this feature of the arbitrator’s power to decide time-related payment disputes, is also a feature of the United Kingdom, New Zealand, Singapore, Malaysia, New South Wales and Western Australia. (In the United Kingdom and New Zealand, any disputes can be adjudicated, not only payment disputes, but also time-related payment disputes.) One of the rationales for this requirement is that according to the DevB’s industry-wide survey in 2011 and its follow-up study in 2023, a claim for extension of time is one of the common causes for payment disputes in construction contracts in Hong Kong, and hence for settlement of time-related payment disputes, it is essential for adjudicators to assess the reasonableness of the claim for extension of time and to ascertain the compensation amount payable.

We will look at how the position has shifted as between the Circular and the Bill:

POSITION UNDER THE CIRCULAR – OCTOBER 2021

Clause 17(1) of the Pilot Provisions state as follows:

“The [adjudicator’s] jurisdiction is limited to determining–

- a. the payment dispute that is referred to adjudication by the Claimant; and*
- b. any other matters that are of a consequential or ancillary nature (including the time or extended time for completion of [the works]) necessary to exercise or complete the exercise of the jurisdiction conferred by paragraph (a).”*

The Circular further explained that, under the security of payment framework, an adjudicator has the jurisdiction to make binding determinations on time-related costs forming part of a payment dispute and, in the process of doing so, to decide on a party’s entitlement to extension of time for relevant delays. While the Circular described the extension of time decided by the adjudicator as non-binding, the Circular also suggested that any rights to liquidated damages or to terminate on

the grounds of delay will be suspended if the works were completed within the extended time decided by the adjudicator.

POSITION UNDER THE BILL – MAY 2024

By contrast, the Bill makes it clear that the adjudicator has the power to decide on extension of time and time-related claims.

Under clause 42(3) of the Bill, if an adjudicator in determining a payment dispute determines that a party is entitled to an extension of time, the adjudicator also must determine (a) the number of days of the extension, and (b) the amount payable based on the extension of time. (Clause 33(1) of the Bill, which is the equivalent of clause 17(1) of the Pilot Provisions in relation to jurisdiction of adjudicators, does not make any express reference to time.)

The adjudicator's power to decide on claims for extension of time and related costs is subject to any applicable claim handling procedure adopted by the parties into their contract.

TRANSITIONAL PERIOD

In the [Legislative Council Brief on the Bill](#), it is explained that the adjudication of time-related disputes initially only will apply to public work contracts and subcontracts, and not private sector contracts and subcontracts.

For private sector construction contracts and subcontracts, clause 56 of the Bill provides that a claiming party may not initiate adjudication proceedings and an adjudicator has no jurisdiction to determine time-related disputes, unless the parties first have agreed on an extension of time and the adjudicator only is asked to determine the amount payable in respect of the agreed extension of time.

Clause 56 will expire on a date to be appointed by the Secretary for Development, following which the adjudication of time-related disputes will apply to private sector contracts and subcontracts (in addition to public sector contracts and subcontracts).

CONCLUDING REMARKS

It is not uncommon for variation claims and time-related costs claims to make up a significant portion of the final contract price. On the one hand, the smooth flow of funds down the sub-contracting chain may turn out to be important to the success of the security of payment regime in reducing the cash flow risks borne by lower tier subcontractors in respect of such claims. On the other hand, it can be foreseen that, if parties are dragged into long and drawn-out disputes regarding the liability and quantum of such claims, there will be a negative impact on the success of the security of payment regime in achieving a speedy resolution of payment disputes. Empirical

evidence will tell how effective the proposed treatment of variation claims and time-related claims under the Bill will be in achieving the objectives of the security of payment regime.

In the UK, the adjudication process is available for all types of disputes, including complex professional negligence claims and delay claims. Parties can refer any type of dispute to adjudication, provided that the dispute has crystallised. Therefore, it is usual practice in the UK for parties first to go through the contractual mechanism, such as by first making an EOT application or submitting valuation and waiting for a response, before going to adjudication.

In Singapore, there is no requirement for variation claims first to go through a claim handling procedure in the contract before adjudication can be commenced. As for time-related claims, in the 2019 amendments to Singapore's Security of Payment Act, claims for damages, losses or expenses (including claims for prolongation costs, and other time-related loss and expenses) are excluded from adjudication unless such claims are supported by any document showing an agreement between the claimant and respondent on the quantum of such claims, or document required to be issued under the construction contract.

From this perspective, it can be seen that Hong Kong's approach is unique but not dissimilar to the approaches taken in overseas jurisdictions. The Government has indicated in the Legislative Council Brief its intention to review and evaluate the implementation of adjudication of EOT entitlements in public sector construction contracts and refine the adjudication mechanism, before implementing the adjudication of EOT entitlements to private sector construction contracts. It remains to be seen how Hong Kong's approach regarding adjudication of EOT entitlements will evolve and develop, as the construction industry adapts to the introduction of the security of payment regime.

As of the date of writing, the Bill is at the Bills Committee stage for further consideration, and no date has been set for resumption of the second reading and for third reading. (For the latest legislative progress, please see [the Legislative Council's website](#).) It would benefit the industry to hear the administration's explanations and the legislators' deliberation on the above matters.

We anticipate that, after the Bill is passed into legislation, there will be continuous developments and debates in the industry regarding how variation claims and time-related claims should be treated in the payment process and the adjudication process under the statutory security of payment regime.

RELATED ARTICLES

- [Security of Payment in Hong Kong – pilot programme for public works contracts](#)
- [SOP in Hong Kong – Public Works Contracts](#)

- [Security of payment circular issued by the Development Bureau of Hong Kong – to take effect from 31 December 2021](#)
- [The new security of payment regime in Hong Kong – key issues to consider before its implementation](#)
- [Hong Kong Security of Payment Bill gazetted](#)

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