

Insights

HK SECURITY OF PAYMENT BILL: AN INSOLVENCY EXCEPTION TO BAN AGAINST “PAY WHEN PAID” CLAUSES?

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SUMMARY

On 16 July 2024, the Hong Kong LegCo Bills Committee which is considering the Construction Industry Security of Payment Bill (“Bill”) held a meeting to receive representations and submissions on the Bill from deputations sent by stakeholders in the construction industry.

Some deputations suggested that the Government should consider specifying cases of non-payment caused by bankruptcy of contractual parties at upper tiers in the supply chain as an exception to the ban against “pay when paid” clauses. The deputations argued that this exception would “prevent series of bankruptcy of various contractual parties at lower tiers”.^[1] (Of course, there always will be one or more parties at the lowest levels that will bear the brunt of the bankruptcy further up the contractual chain.)

Insolvency exception to “pay when paid” in the UK

As mentioned in the Hong Kong Government’s consultation document, the UK^[2] has this exception in its relevant statutory provision which bans “pay when paid” clauses, and a rationale was that in insolvency there should be no special treatment of particular parties or industries.^[3] For example, it might be considered unfair if a sub-contractor in the construction industry can force a main contractor to pay when the employer has become insolvent, but a sub-contractor in a non-construction industry cannot do so to the same main contractor.

In the UK, section 113 of the Housing Grants, Construction and Regeneration Act 1996 (“**Section 113**”) provides that:

“A provision making payment under a construction contract conditional on the payer receiving payment from a third person is ineffective, **unless that third person, or any other person payment by whom is under the contract (directly or indirectly) a condition of payment by that third person, is insolvent.**” (emphasis added)

In other words, under UK Section 113, if a contractual provision in a construction contract provides that a payment (e.g. to a sub-contractor by a main contractor) is conditional on payment being made by a third party (e.g. an employer), that contractual provision will be effective (and will not be caught under the ban against “pay when paid” clauses) if that third party is insolvent.

However, Section 113 can be argued to be unfair to sub-contractors further down the supply chain, because the credit risk is being re-allocated down the supply chain and the lower (or lowest) sub-contractors essentially are acting as credit insurers to the main contractors on the employer’s insolvency. Further, another major criticism of UK Section 113 is that it does not provide a mechanism for a main contractor to distribute any monies received by it from the liquidator / administrator, or impose an obligation on a main contractor to inform its sub-contractors of any monies the main contractor has received from the liquidator / administrator.

Will Hong Kong adopt an insolvency exception?

It is noted that during the Bill’s consultation process, 69% of the respondents to the consultation agreed that “pay when paid” clauses should be ineffective “even where the reason for non-payment is insolvency higher in the supply chain”^[4].

It remains to be seen whether the Government would use the consultation result to resist the introduction of an insolvency exception, or whether the Government would be willing to re-open this issue for further discussion.

The LegCo Bills Committee will be returning from its summer break and has scheduled meetings on 3 and 14 October 2024 to continue to discuss the policy issues concerning the Bill.

BCLP will continue to provide key updates to the Bill’s developments in the LegCo as and when they occur.

[1] See paragraph 2 of the [minutes of the Bills Committee on 16 July 2024](#).

[2] Another country which has this exception is Ireland.

[3] See paragraph 6 under Proposal 13, at page 24, of the [Consultation Document published by the Development Bureau \(June 2015\)](#).

[4] See paragraphs 72 to 74 of the [Consultation Report published by the Development Bureau \(April 2016\)](#).

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