

Insights

HK SECURITY OF PAYMENT ORDINANCE: WHAT DIFFERENCE MIGHT IT MAKE IN PRACTICE?

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SUMMARY

In *Wang & Lee Contracting Ltd v Young Kwong Pui Trading as In Tech Engineering* [2025] HKDC 66 (Date of Decision: 3 January 2025), the District Court ordered the court proceedings to be stayed and that the plaintiff's claims be referred to arbitration.

The court's decision to grant a stay in favour of arbitration is entirely unsurprising and is consistent with Hong Kong courts' pro-arbitration stance. What this article will explore is how this dispute might have proceeded along a different trajectory if the newly enacted Construction Industry Security of Payment Ordinance (Cap 652) ("**Ordinance**") had been in force and applied to this dispute and the facts leading up to it.

SUMMARY OF THE FACTS

By a written agreement dated 24 August 2022 ("**Agreement**"), the plaintiff (the sub-sub-contractor) ("**P**") engaged the defendant (the sub-sub-sub-contractor) ("**D**") to carry out electrical installation works.

The Agreement contained an arbitration clause which provided that "*in the event of a contractual dispute between the parties, it must be handled in accordance with the latest arbitration regulations.*"^[1]

P's case was that it terminated the Agreement on 16 August 2023.

D's workers complained to the sub-contractor that they had not been paid their wages.

D said it was unable to pay its workers because P had not made timely payments pursuant to the Agreement, but P said it did not release the payments because D did not adhere to the agreed schedule of the progress of the works.

After meetings in August 2023, P agreed to settle the outstanding wages to D's workers based on their market rate and attendance records, and P did pay an aggregated sum of HK\$575,483.67 ("**Sum**") to D's workers.

In February 2024, P commenced proceedings to recover the Sum from D, on the basis that the Sum was a loan provided to D pursuant to an oral agreement, and/or pursuant to the Employment Ordinance^[2].

D denied entering into any loan agreement with P, and emphasized that the Sum was part of D's contractual entitlement under the Agreement.

Further, relying on the final account annexed to its invoice dated 15 September 2023, D contended that P owed D a sum of HK\$1,477,631.91 under the Agreement. D therefore contended that, even if D was liable to pay P the Sum, D was entitled to rely on P's indebtedness of HK\$1,477,631.91 to set off against the Sum.

STAY OF LITIGATION IN FAVOUR OF ARBITRATION

D then sought to stay P's claims in favour of arbitration pursuant to section 20 of the Arbitration Ordinance (Cap 609)^[3].

The main issue that the court had to decide was whether the dispute between the parties fell within the ambit of the arbitration clause.

P relied on what it said was the narrowly drafted wording of the arbitration clause (which covers "contractual disputes"), and contended that, because P's claim was based on a separate loan agreement and/or the Employment Ordinance, the arbitration clause was not engaged.

The court rejected P's contention, primarily because the court was of the view that it was plain that D's defence constituted "contractual disputes" in respect of the Agreement. As mentioned above, D's defence was that the Sum represented part of D's contractual entitlement **under the Agreement**, and that the sum of HK\$1,477,631.91 was an amount owed by P to D **under the Agreement**.

The court therefore decided that the dispute did fall within the ambit of the arbitration clause, and made an order to stay the proceedings in favour of arbitration.

A CASE STUDY: WHAT IF THE CONSTRUCTION INDUSTRY SECURITY OF PAYMENT ORDINANCE HAD APPLIED?

While D "won" the stay application, the unsatisfactory state of affairs was that none of the participants in this part of the project could be described as being "winners" in the grander scheme of things:

1. From D's perspective, some one and a half years after the conclusion of final account there remained a sum of nearly HK\$1 million^[4] allegedly owing by P to D. D had not yet commenced recovery (arbitration) proceedings to recover this final account balance, possibly in part because of some financial difficulties, which are suggested by D having been unable to pay the salaries of its workers.
2. From P's perspective, what seemed at first blush to be a simple demand for repayment of a loan had now become a full-blown dispute, with costs wasted by court proceedings being aborted in favour of a wider arbitration.
3. From the perspective of D's workers, they had to complain about non- and late-payment of wages.

Given the Ordinance's stated aim to "*facilitate the recovery of payments under construction contracts; to provide a mechanism for speedy resolution of payment disputes under certain construction contracts through adjudication proceedings*"^[5], it begs the question as to whether the dispute between P and D would have played out differently if the Ordinance had applied to this case.

The analysis below (which of necessity is simplified and somewhat superficial) will focus on the following three aspects:

1. RIGHT TO PROGRESS PAYMENT AND DEADLINE FOR PAYMENT^[6]

The starting point is that D would have had a statutory right to progress payments, the amount of which was to be assessed according to the progress of the construction works^[7].

D would have been entitled to serve a payment claim on P in respect of a progress payment, and P in turn would have been required to make payment within 60 days (or a shorter period if provided for under the Agreement).

2. ADJUDICATION

If P had not paid the progress payment(s) in a timely way, D would have had the statutory right to commence adjudication proceedings. If D was facing pressure to pay the salaries of its workers, it may be assumed that D is likely to have commenced adjudication against P for disputed amounts early on during the project, rather than waiting (as D in fact did) until the end of or after the project to commence recovery proceedings.

Sometimes small industry participants (such as D) do not take recovery action in a timely way, even though they would like to. This can be because of the prohibitive cost of arbitration proceedings, and also because many dispute resolution clauses in Hong Kong say that arbitration cannot take place until the end of the project.

3. RIGHT TO DELAY WORKS

The statutory right to delay works might have given D another incentive to commence adjudication against P as early as possible.

Under section 60 of Ordinance, if D had received an adjudication decision in its favour and P failed to pay by the payment deadline of the adjudicated amount, D (after fulfilling certain preconditions) would have had the statutory right to delay the carrying out of its electrical installation works. That would have put obvious and very real pressure on P to pay the adjudicated sum promptly.

Tactically, D would want to obtain the right to delay works as early as possible, so as to afflict more impact on the project's other works.

CONCLUSION

In an ideal world under the Ordinance, payment disputes are encouraged to be resolved as early as possible in the project cycle, and stakeholders up the line have incentives to step in to see that disputes down the line are resolved promptly.

Adjudication is often described as a "pay now, argue later" mechanism which aims at improving cash flow down the supply chain. As opposed to litigation or arbitration where parties often are said to fight "tooth and nail", stakeholders in the construction industry (whether or not they are parties to an adjudication) have good reasons to hope that payment disputes can be and will be resolved earlier and more swiftly under the statutory adjudication scheme.

FOOTNOTES

[1] The relevant Chinese contractual provision was not translated into English in the judgment. This English translation is provided by the authors of this article.

[2] In particular, section 43F(1) which states "*[i]f a principal contractor or superior sub-contractor pays to an employee any wages under section 43C, the wages so paid shall be a debt due by the employer of that employee to the principal contractor or superior sub-contractor, as the case may be.*"

[3] Sections 20(1) and (5) of the *Arbitration Ordinance* (Cap 609) provide that:

"(1) A court before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party so requests not later than when submitting his first statement on the substance of the dispute, refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed"

“(5) If the court refers the parties in an action to arbitration, it must make an order staying the legal proceedings in that action.”

[4] Setting off HK\$575,483.67 with HK\$1,477,631.91 gives a net figure of HK\$902,148.24.

[5] Preamble of the Ordinance.

[6] See sections 13 to 18 of Ordinance.

[7] Paragraph 11 of the judgment records that P admitted that based on the terms of the Agreement, the wages should be released according to the progress of the works.

RELATED PRACTICE AREAS

- Construction Disputes
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- Litigation & Dispute Resolution
- Business & Commercial Disputes

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