

## **Commentary - Observations on the Three-party Provisional Agreement for Sale and Purchase**

### **[2010] HKIEA C2**

#### **1. Introduction**

- 1.1 In Hong Kong the most common way to sell or buy a home is by private treaty, i.e. private negotiation between the vendor and purchaser, normally done through an estate agent. Sale by tender or auction is possible but less common. This discussion assumes that an estate agent is engaged, and that our Commentary *Things to Note on Estate Agency Agreements - [2010] HKIEA C1*- has been read.
- 1.2 After the vendor and purchaser have agreed to their desired terms the estate agent will prepare a provisional agreement for sale and purchase ('PASP') to record the agree terms. A PASP prepared by estate agents, though called provisional, is a concluded agreement but yet may not bind the parties to a sale and purchase of the property. This peculiarity will be explored below.
- 1.3 Due to the prevalence of dual agency in Hong Kong, the common practice here is to add the estate agent as a party to the PASP making it a 3-party agreement ('3p-PASP')<sup>1</sup>. As the agreement is drafted by the estate agent, it may come as no surprise that where the interests of the estate agent and his client come into conflict, the agreement may be biased in favour of the estate agent – see report on the Institute's website entitled *The Provisional Agreement for Sale and Purchase – R.I.P* ('the Report').
- 1.4 This Commentary aims to explain in simple terms three of most misunderstood features of the 3p-PASP. The Estate Agents Authority and the Consumer Council have jointly published the following pamphlets for the advice of the public:
  - (a) a *Guide to Purchasing Properties*

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<sup>1</sup> There is a two-party PASP, but not intended for use by estate agents – see Section IV *The Way Forward* and *Postscript* of the Report.



<http://www.eaa.org.hk/consumers/doc/property.pdf> , and

(b) a *Notes to Purchasers of First-hand Residential Properties*  
<http://www.eaa.org.hk/publications/property Pamphlet.pdf>.

Matters covered by them will not be repeated here.

## **2. Feature One - that though the 3p-PASP is a concluded agreement yet it may not be binding in respect of the property**

2.1 A 3p-PASP, though a concluded agreement, normally incorporates *escape clauses*<sup>2</sup> giving either party the choice of ‘alternative performance’. This means that either party could sell or buy the property in accordance with the terms of the agreement. However, if he changes his mind ***before*** the formal agreement is signed<sup>3</sup>, he could take the alternative *escape* course by paying compensation equal to the initial deposit to the other party (if the vendor changes his mind), or forgoing the initial deposit (if purchaser). The agreement will then be discharged and the innocent party, even if he suffers greater loss, will have no other remedies against the party who withdraws.

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<sup>2</sup> See para. 93 of the Report. They will say (Clauses 6 & 7 of the Annex are typical) :

(a) regarding the purchaser’s rights and obligations –

*Should the Purchaser fail to complete the purchase in the manner herein contained the deposit shall be forfeited to the Vendor and the Vendor shall then be entitled at his absolute discretion to sell the said premises to anyone he thinks fit and the Vendor shall not sue the Purchaser for any liabilities and/or damages or to enforce specific performance.*

(b) regarding the vendor’s rights and obligations -

*Should the Vendor after receiving the deposit paid hereunder fail to complete the sale in the manner herein contained the Vendor shall immediately compensate the Purchaser with a refund of the initial deposit together with a sum equivalent to the amount of the initial deposit as liquidated damages and the reimbursement/ payment (as the case may be) of stamp duty of the said premises and the Purchaser shall not take any further action to claim for damages or to enforce specific performance.*

<sup>3</sup> A formal agreement for sale and purchase, with no escape route, will normally be signed at the solicitors’ office within 14 days of the 3p-PASP.

- 2.2 Provided that the parties know their full implications there is nothing inherently wrong with *escape clauses*, in particular if the property is for investment purpose and profit is the motive. However, if a property is purchased with other objectives in mind, like in order to care for a relative living nearby or to enable a child to enter a particular school catchment area, then escape clauses may defeat the purpose.
- 2.3 If both parties wish to preserve all the remedies open to him (such as the right to sue for specific performance of the agreement) in the event that the other party defaults then these *escape clauses* should be deleted. Deletion will unlikely impact on the validity of the rest of the agreement.
3. **Feature 2 - that the client who ‘defaults’ has to compensate the dual agent not only with the agency commission payable by himself but also that payable by the other party**
- 3.1 As explained in para. 3.5.3 of our Commentary *Things to Note on Estate Agency Agreements*, there are clauses<sup>4</sup> in the 3p-PASP demanding the client to pay the estate agent not only his agency commission but also that payable by the other party in the event that the client does not complete the purchase.
- 3.2 The estate agent has no legal right to demand the client to pay him the commission payable by the other party<sup>5</sup>. By putting his own self interest above the client’s interest the estate agent has breached his fiduciary duty. This is the main thrust of the Report at pages 4 – 18.
- 3.3 Both the vendor and purchaser should delete these clauses. The agent’s right to and the amount of agency commission payable are set out in the estate agency agreements which is the first thing a client should sign when

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<sup>4</sup> Similar to Clause 9 of the Annex to the Report. \$[X] is usually the sum total of the negotiated agency commission payable by both V and P.

<sup>5</sup> The Practice Regulation stipulate in Extra Terms and Schedule 2/3 of Form 3/4 that:

- (a) any extra terms agreed between the estate agent and his principal cannot contradict the terms of the prescribed agreement; and
- (b) only the defaulting party, not the innocent party, has to pay agency commission.

appointing an estate agent. The commission clauses in the 3p-PASP are totally superfluous and can be deleted without prejudicing the estate agent's interests.

#### **4. Feature 3 - that an entire contract clause may result in unfair consequences**

4.1 An entire contract clause is usually the last clause in a 3p-PASP (Clause 12 of Annex to Report) and reads something like:

*This agreement supersedes all prior negotiations, representation, understanding and agreements of the parties hereto.*

4.2 In a nutshell, this clause means that even if a party was abused with lies (or omissions) during the course of negotiation, once the 3p-PASP is signed he cannot claim that he was misled into signing it (see pages 18 – 22 of the Report).

4.3 An entire contract clause is common place in commercial contracts. Indeed there will be one in the formal agreement for sale and purchase which will usually be signed at a solicitors' office 14 days after signing the 3p-PASP. The problem is that very often the client is not fully explained the impact of this clause by the estate agent who, unless properly trained, may not himself understand it.

4.4 It is therefore advisable for the vendor and purchaser to delete this clause. The purchaser is particularly vulnerable as lies or omissions, if any, are more likely to come from the side of vendor or his agent. The validity (or otherwise) of the 3p-PASP will not be impacted if this clause is deleted.

#### **5. Concluding remarks**

5.1 A vendor (or purchaser) should be served by an estate agent who is totally loyal to him, and him alone. There is inherent conflict of interest in dual agency<sup>6</sup>.

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<sup>6</sup> For this reason estate agents in New Zealand may no longer receive agency commission from both sides to a property transaction.

- 5.2 Dual agency will not bring the client any advantage over and above what is already rightfully his when he appoints his own single agent.<sup>7</sup> Therefore when asked to give permission for dual agency, the client should think very carefully before agreeing.
- 5.3 Further, if your estate agent is a single agent working for you only then there is no reason why you should sign a 3p-PASP at all. There may be other alternatives.<sup>8</sup>
- 5.4 Finally, do not forget that it is always advisable to seek legal advice before signing any sale and purchase agreement.

Research Division

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<sup>7</sup> see paragraph 34 of the Report

<sup>8</sup> see pages 28 – 30 and postscript of the Report. There is an optional agreement form (Form 2) at Schedule 3 of the *Conveyancing and Property Ordinance*, but that will require deep property law knowledge beyond most estate agents' ability to handle.