Hong Kong Institute of Estate Agents
香港地產代理學會

Commentary – Adrift in the Compulsory Sale Deluge

[2010] HKIEA C3

1. Introduction

1.1 After much heated debate in the Legislative Council ('Legco'), the *Land (Compulsory Sale for Redevelopment) (Specification of Lower Percentage) Notice* became law and came into force on 1st April 2010. The majority owner of a building may now apply to the Lands Tribunal under the *Land (Compulsory Sale for Redevelopment) Ordinance* Chapter 545 for an order to sell the *undivided shares*[1] of the lot for redevelopment if he owns:

(a) not less than 90% of the undivided shares of an ordinary building; or

(b) not less than 80% of the undivided shares if the building belongs to one of the following classes:

(1) each unit representing more than 10% of the undivided shares, i.e. a building with less than 10 units;

(2) its occupation permit was issued at least 50 years ago;

(3) an industrial building within a non-industrial zone and its occupation permit was issued at least 30 years ago.

1.2 Acquisition[2] of old buildings for redevelopment is probably outside main stream estate agency work, and Cap. 545 is not in the examination syllabus of the Estate Agents Authority ('EAA'). Recently the tactics of certain estate agents practicing acquisition have caught the attention of EAA.[3]

1.3 Potential home owners have expressed concern to their estate agents about

[1] It means a proportion of shares in the whole building allocated in the conveyance to a flat owner; a peculiar Hong Kong device to ensure that everyone gets a proportion of the whole block plus the flat actually allocated to him – *Bramwell.*

[2] Compulsory acquisition and compulsory sale are used interchangeably here, as they are two sides of the same coin; 'he' includes 'she' and 'it'.

[3] EAA press release of 17 March 2010 http://www.eaa.org.hk/prdoc/2010-03-17e.pdf.pdf

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whether the unit in a no-frills, low-rise, building that they are interested in[4] might face the hammer soon after they purchase it. This concern alone may depress the demand for, and thus the value of, these properties to the delight of developers[5] on the prowl.

1.4 Rather than analyzing in detail the pros and cons of compulsory sale which is beyond the scope of this column, this Commentary aims to suggest one or two things that a home owner could do to defend his *castle*[6] against invaders.

2. The Role of the Lands Tribunal in Compulsory Sale

2.1 Government told Legco in the recent debate that the Lands Tribunal is a bastion of protection for minority owners.

2.2 As the debate showed, the efficacy of the Lands Tribunal to do justice to minority owners at the receiving end of the compulsory sale application has received a mixed verdict at best[7]. The Tribunal has (before the recent addition of the 80% threshold categories) outlined the matters that it has to consider before granting a compulsory sale order, as follows:[8]

(a) the majority owner (i.e. the developer of his agent) owns more than 90% of their undivided shares;

(b) the application is enclosed with a valuation report on the existing use value ("EUV") of the buildings (and the individual units therein), dated not more than 3 months before the application;

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[4] a favourite for people adverse to posh high rise housing estates - in most cases meaning a building at least 30-40 years old

[5] The purchaser/majority owner/developer metamorphosis takes place as the compulsory acquisition process progresses.

[6] 'An Englishman's home is his castle' *Magna Carta.*

[7] For example, the sentimental value to the minority owners or whether there was any public interest need for redevelopment are not factors that have to be considered. Monetary value dominates the determination.

[8] LDCS 11000 / 2006, paragraphs 3 – 4

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(c) redevelopment is justified on the ground of age or state of repair of the existing buildings, and

(d) the majority owner has taken reasonable steps to acquire all the undivided shares of the lots, which steps shall include negotiating for the purchase of them on fair and reasonable terms.

2.3 Cap. 545 further provides that:

(a) if the minority owners (i.e. the castle defenders) dispute the EUV of any of the properties as assessed in the application, the Tribunal shall have to first determine that dispute;

(b) if the Tribunal makes an order for sale, unless the parties otherwise agree, it should direct the sale to be made by way of a public auction, and fix a reserve price for the sale, which price should take into account the redevelopment value ("RDV") of the lots;

(c) if the sale is completed, the Tribunal shall also direct that the minority owners shall receive their proportionate share of the sale proceeds by reference to the ratio between the determined EUV of their respective unit and the total EUV of the buildings.

2.4 The minority owners will therefore be compensated for losing their castle. The recent market value of the property will provide reference for the amount of compensation they will get. But how can they tell if the offer price is fair or not? No challenge to the purchaser's application or valuation will likely succeed unless the minority owners can afford their own valuation expert and legal advice[9]. Statistics show that the compulsory sale method, even if within the letter of the law, may be perfunctory for the protection of the minority owners[10]. Worse still, successive tribunals have applied

[9] As happened to the lonely minority owner in Kai Yuen Lane, North Point - *Ming Pao Daily News* 18 March 2010. Armed with no lawyer or surveyor but a sense of grievance, he lost. Another who lost the fight before the Tribunal had to pay around $4 million for his own and the developer's legal costs, amounting to half of what the developer paid for his Causeway Bay shop – *South China Morning Post* 18 March 2010.

[10] The Development Bureau's July 2009 paper to Legco shows that, of the 20 compulsory sales by auction conducted under Cap. 545 between 1999 - 2009, 18 were sold at the reserve price. This must come as no surprise as normally the only bidder was the majority owner. The *South China Moring Post* of 4 May 2010, covering the auction the day earlier pursuant to a

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armchair economists' theories to their determination which may not stand up to scrutiny by higher courts[11].

2.5 To the minority owners in a target building in Tai Kok Tsui already suffering from mysterious fires and stoppages of water supply[12], and with the spectre of a legal costs bill many times the value of their homes hanging over their head[13], the prospect of mounting a successful challenge at the Lands Tribunal must look surreal.

3. The Hazards of Dual Agency in Compulsory Sale

3.1 Unscrupulous tactics of *compulsory sale* estate agents

3.1.1 EAA is investigating unspecified malpractices of these agents[14], which according to press report included high pressure tactics and alleged

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compulsory sale order (LDCS 9000/2008), reported '(*the majority owner) said the result should be fair to the owners because 'everything was done according to the law…'* but in the paragraph next '… *an activist concerned about compulsory sales said the shop owner had objected to the compulsory sale and sought a 'shop for shop' option, but settled in the end because of legal costs*'. The *Ming Pao Daily News* reported that the minority owners attending that auction had made a report to the police present that they were cheated. As the majority owner was, again, the only bidder, the building was sold at the reserve price just like the previous 18.

[11] CACV 95/2009 para. 33-36 (decided 28 May 2010). In that case the Lands Tribunal also wrongly allowed the majority owner to revalue downwards, against the minority owner's objections, the *agreed* reserve price due to the market downturn during the 6 months hearing adjournment. As the auction was completed the Court of Appeal, while finding against the tribunal, said it could not rewind the clock. What a Pyrrhic victory for the minority owner who lost 40% of the value (reduced from $14.7 million to $8.48 million) of his Causeway Bay shop!
http://legalref.judiciary.gov.hk/lrs/common/ju/ju_frame.jsp?DIS=71207&currpage=T

[12] *Ming Pao Daily News* 29 March 2010

[13] Generally in a civil suit the loser has to bear the winner's legal costs. One challenger, whose Wanchai unit has a EUV of only $2 million, has to bear substantially the developer's $14 million legal costs. Admittedly the court had found the challenge 'devoid of merits' (CACV 241/2008).

[14] EAA press release, ibid

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criminal acts of arson and threats etc[15]. There may be little that the minority owners can do apart from reporting to the authorities[16].

3.1.2 There may however be one small thing that they can do to lessen the harm – to appoint an estate agent to represent their interest *only*, thereby declaring that they will have nothing to do with the developer's agent. The general merits of having your own single agent in property transactions have been discussed in our Commentary - *Observations on the Three-party Provisional Agreement for Sale and Purchase.*

3.1.3 Your single agent should be able to tell what are the limits of lawful and ethical estate agency practice. As the developer's agent is not supposed to contact another agent's client (the minority owners) direct, this may shield the minority owners from most, if not all, harassments. For example, a minority owner need no longer worry about receiving repeated 'follow up' knocks on the door from the developer's agent, often as late as midnight[17].

3.2 The dual agent's built-in bias in favour of the majority owner

3.2.1 The bias is self-evident in light of the following practice in the compulsory acquisition scene:

a. one player, Developer H, dominates the market (reportedly a 70% share);[18]

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[15] *Ming Pao Daily News* 17 March 2010

[16] The harassment will unlikely cross the criminal law boundary so as to invite police intervention, the same way that debt collectors calculate their *modus operandi*.

[17] To one minority owner's complaint that the dual agent had made repeated unannounced home visits between 9 pm and mid-night, the dual agent (a staff of Agent R, see later) replied that he was only '*fulfilling his duty to keep the owner informed of the development of the acquisition*' of the building - *Ming Pao Daily News* 17 March 2010. There can be no such excuse if the minority owners have their own single agent. All communication should then be between the estate agents themselves with no direct contact with the other agent's client.

[18] *Ming Pao Daily News* 12 April, 2010

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b. one estate agent (Agent S) handles over 50% of compulsory acquisitions;[19]

c. the estate agent may become the end user himself, i.e. he may act for a developer or he may re-develop the land lot himself. It is therefore no surprise that one such agent (Agent R) has received numerous complaints of harassment from minority owners.[20]

3.2.2 The partnership between Developer H and Agent S is long term. In one recent deal, the purported purchase of eleven units in a Mid-levels target building was bundled in one joint sale agreement (notwithstanding the 11 individual sale and purchase agreements signed)[21]. Agent S, as dual agent would receive 1% of the purchase price @ $15 million from each of the 11 minority owners and 11 x 1% from the purchaser (associated with Developer H). One might legitimately question whether an estate agent would treat each of the minority owner paying $0.15 million agency commission individually as fairly as he would treat the purchaser paying $1.6 million, when Developer H (unlike the minority owners) would keep feeding Agent S business in the future.

4. Beware of unfair contract terms

4.1 Lock-out agreement in the stronger party's favour

4.1.1 In the case of the Mid-levels building mentioned above, the sale and purchase agreement gave the purchaser the right to terminate the agreement if the purchaser could not enter into a 'conditional provisional sale and purchase agreement' with 90% of the owners of the building within three months. This right was unconditional and the purchaser was not even required to use 'reasonable endeavours' to acquire the 90%.

4.1.2 Soon after the notice to lower the compulsory sale threshold to 80% was gazette by Government, the purchaser exercised the right of termination to end the deal and the minority owners had to return in full the deposits

[19] *Ming Pao Daily News* 16 March, 2010

[20] *Ming Pao Daily News* 17 March 2010

[21] Actually there were a total of 13 units, but two were outside the bundle of 11.

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received[22]. What they received from the bargain was a three month locked-out in return for $0. They could not back out of the deal or sell to another until the purchaser exercised his right of termination. Therefore it is a classic illustration of unfair contract terms crafted in favour of the stronger party. Unfortunately this deal was not unique in compulsory acquisitions.[23]

4.2 If you cannot resist it, make the purchaser pay for the privilege

4.2.1 If a minority owner has no choice but to submit to signing an agreement giving the purchaser unilateral right to terminate on not getting the requisite percentage ownership, then the purchaser should at least be made to pay for the privilege[24].

4.2.2 Paying for the privilege to terminate a contract is common. As mentioned in our Commentary *Observations on the Three Party Provisional Sale and Purchase Agreement*, most provisional agreements will give a defaulting party the option of alternative performance (i.e. to back out of a deal) by forsaking, or paying an amount equal to, the deposit. There is no reason why a purchaser intent on compulsory sale should not pay at least the same price for the more lucrative prospect of redevelopment.

5. Concluding remarks

5.1 In compulsory acquisitions, the minority owners have to deal with a much more experienced and resourceful purchaser analogous to the *David vs Goliath* fight. This is particular so in run-down districts like Sham Shui Po or To Kwa Wan, despite Government's assertion that the law strikes a 'fair' balance between the rights of both sides.

5.2 For self-preservation, minority owners should appoint their own single agent, and seek legal advice and independent valuation before signing any agreement. Without your own valuation, the Lands Tribunal will unlikely

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[22] Having crossed the 80% mark jointly with another developer - *Sing Tao Daily* 24.3.2010

[23] In an earlier Kowloon case there was a unilateral 12-month lock-out period. The purchaser exercised the right when he failed to acquire the requisite percentage and sued the minority owners when they could not repay the deposit.

[24] In the cancelled deal above arranged by Agent S, the purchaser only agreed to reimburse up to $28,000 spent legal costs and the minority owner received not a cent for the lock-out.

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be able to substantially vary the EUV etc. provided by the purchaser's expert. Note that this kind of sale is anything but ordinary.

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