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Bills Committee on Statute Law (Miscellaneous Provisions) Bill 2001

Background Paper prepared by the Legislative Council Secretariat

Power of Court to Order Repayment of Deposit (Part VII of the Bill)

Purpose

This paper sets out the discussion held by the Panel on Administration of Justice and Legal Services on the court's power under section 13 of the Conveyancing and Property Ordinance (CPO). The issue was discussed by the Panel at meetings on 15 February 2000, 20 June 2000, 20 February 2001 and 26 April 2001.

Background

2. Godfrey JA, in Wu Wing Kuen v Leung Kwai Lin Cindy (1999), held that the court has no power under section 13 of CPO to order the vendor to return the deposit to the purchaser even though this had been lost through no fault of the latter. He urged that local court should be given a discretionary power similar to that conferred on the courts in the UK under section 49(2) of the Law of Property Act 1925 (LPA) -

"(2) Where the court refuses to grant specific performance of a contract, or in any action for the return of a deposit, the court may, if it thinks fit, order the repayment of any deposit."

3. The Panel decided to follow up the matter with the Administration. The Administration undertook to consult relevant organisations including the two legal professional bodies and the Consumer Council on the proposal to adopt in Hong Kong an equivalent of section 49(2) of LPA.

Outcome of the consultation exercise

4. On 20 June 2000, the Administration reported to the Panel that the consultation had shown that the proposal was a complex and controversial matter on which opinions were divided. The Hong Kong Bar Association and the Consumer Council favoured the proposal. Members of the Law Society of Hong Kong and the Hong Kong Conveyancing and Property Law Association Limited could not reach a consensus. The Real Estate Developers Association of Hong Kong expressed concern that the proposal would jeopardise the sanctity of contract and lead to many frivolous and unmeritorious litigation instigated by parties trying to renege on signed agreements.

5. The results of the consultation did not point to a simple legislative reform addressing the problem. In view of the complex issues involved, the diverse views received and the far-reaching implications for the local conveyancing practice, the Administration considered that the following issues raised in the consultation exercise required further detailed study -

- (a) whether the court should (if at all) be given an unfettered discretion or a qualified discretion;
- (b) issues such as statutory interference in the freedom of contract, the competing rights of purchasers and vendors, and the certainty of property transactions;
- (c) the desirability to introduce any change to the property market which was an important element of the Hong Kong economy; and
- (d) the steps involved in conveyancing transactions in Hong Kong were different to those in the UK and it might be technically more complicated to implement the proposed changes than merely to transplant the UK provisions to Hong Kong.

The Administration's proposal

6. At the meeting on 20 February 2001, the Administration put forward the following proposal for members' consideration -

- (a) a provision equivalent to section 49(2) of LPA be introduced by way of an amendment to section 12 of CPO; and
- (b) such amendment included an express prohibition against contracting out of the provision.

The Administration's paper (LC Paper No. CB(2)864/00-01(04)) submitted to the Panel is at **Appendix I**. The paper sets out, inter alia, the law in England and Australia, as well as the arguments against and for introducing a provision equivalent to section 49(2) of LPA. A summary of the responses of the consultees is at Annex to the paper.

Views of the legal professional bodies

7. When the issue was last discussed by the Panel at the meeting on 26 April 2001, the Panel noted that the Bar Association and the Law Society had changed their respective positions on the issue since the consultation exercise conducted by the Administration. The Bar Association considered that on the whole, it would be undesirable to give a discretionary power to the court to order the repayment of the deposit. The Council and the Property Committee of the Law Society supported the proposal in principle subject to further review of the detailed provisions of the legislation and the proposed discretionary power being narrowly drafted.

Views of the Panel

8. The Panel did not reach any consensus on the matter at its meeting on 26 April 2001. Hon Audrey EU had serious reservations about the Administration's proposal and made a written submission to the Panel. Hon Miriam LAU considered that to protect the sanctity of contract, the court's discretion should be qualified. Hon Ambrose LAU did not think that there was an immediate need to introduce the proposal as cases in which it was appropriate for the court to exercise the discretion were likely to be few and implementation of the proposal could lead to unnecessary litigation. Hon Martin LEE considered that there were merits in providing the court with such a discretionary power as the courts in UK and Australia had similar powers. Nevertheless, the Administration should further justify its proposal in view of the diverse views received. Hon Albert HO had yet to come to a decided view on the proposal.

9. Members may refer to the minutes of the meeting on 26 April 2001 and the submissions from Hon Audrey EU, the Bar Association and the Law Society which have been circulated to the Bills Committee vide LC Paper No. CB(2)1270/01-02(04).

The Administration's position

10. The Administration provided responses to the various issues raised in the submissions from Hon Audrey EU, the Bar Association and the Law Society (LC Paper No. CB(2)1249/00-01(02)), a copy of which is at **Appendix II**.

11. The Administration remains of the view that the proposed legislative amendment should be introduced.

Council Business Division 2
Legislative Council Secretariat
15 March 2002

Legislative Council Panel on Administration of Justice and Legal Services

Meeting on 20 February 2001

**Paper on proposed amendment to the
Conveyancing and Property Ordinance (Cap. 219)
to enable a court to order repayment of any deposit**

The problem

In Wu Wing Kuen v Leung Kwai Lin Cindy [1999] 4 HKC 565, 576, Godfrey JA criticised the lack of a power of the court under Hong Kong conveyancing law and practice to order the vendor to return a deposit made by the purchaser –

“I share the Recorder’s regret that the purchasers in the first case have lost their deposit through no fault of their own. We cannot order that their deposit be returned to them; for we have no power to make such an order. Section 49(2) of the Law of Property Act 1925 gives the court such a power in England and Wales. I have previously urged the incorporation of such a power in local legislation but my urgings have fallen on deaf ears. Once again, I commend it to the legislature here to confer such a power on the court. This would enable the court to do justice in cases like the present, in which the system operates unfairly against purchasers. The courts need to be able to stem the flood of cases in Hong Kong in which vendors are able to achieve windfall profits at their purchasers’ expense. The sooner something is done about this disgrace, the better.”

Background

(1) The law relating to deposits

2. Sihombing and Wilkinson Hong Kong Conveyancing Law and Practice (“HKCLP”), Vol. 1A, para. [1751], defines a “deposit” as the part payment of the

purchase price for the purchase of land. It functions as an earnest and guarantee of performance which may be forfeited on the purchaser's default.

3. In Soper v Arnold (1889) 14 App Cas 429, 435, Lord Macnaghten described the deposit as serving two purposes. If the purchase is carried out it goes against the purchase money. But its primary purpose is as a guarantee that the purchaser means business. The deposit acts as a guarantee because on default the deposit remains the property of the vendor.

4. HKCLP, para. [1751], also notes that one effect of classifying the deposit as an earnest of performance is that where the deposit has not been paid, and the contract does not proceed, the vendor is entitled to sue for its recovery. This can be done by way of debt. However, if the amount of the deposit is excessive so that it cannot be regarded as an earnest, the court must assess the damages to which the vendor is entitled flowing from the purchaser's breach. The usual amount of a deposit is 10% of the purchase price.

5. Notwithstanding the function of the deposit as an earnest and guarantee, equity has an inherent, but narrow, jurisdiction to relieve against forfeiture e.g. on grounds of fraud, accident, surprise or mistake (HKCLP, para. [1802]).

6. Limited relief in equity is available where the contract is for the sale of land (HKCLP, para. [1803]). The fact that a valid and binding contract creates an interest in equity in favour of the purchaser has not been considered sufficient to allow the purchaser to obtain equitable relief. In Steedman v Drinkle [1916] 1 AC 275 it was held that, where the purchaser fails to observe an essential time stipulation, the vendor is entitled to forfeit the deposit and terminate his equitable interest on the ground that the reason for making time essential was to achieve certainty in the relationship, so that the purchaser knew that if he failed to perform on time he would lose both his deposit and his equitable interest in the absence of the limited grounds for invoking jurisdiction.

7. The equitable jurisdiction has been widened in Australia by overlooking the failure of the purchaser to perform the contract and allowing relief where forfeiture of the deposit would be unconscionable (HKCLP, paras [1804], [1805] – [1850]). In Legione v Hateley [1983] 152 CLR 406, for example, the purchasers entered into possession pending completion of a contract in which time was of the essence and built a house upon the land. They failed to complete on the due date after receiving a non-committal answer to their request for an extension from a clerk of the vendors’ solicitors. Gibbs CJ and Murphy J, p.429, held that in the circumstances it would be unjust for the vendors to insist on forfeiture of the purchasers’ interest in the land. If the contract were rescinded the vendors would receive “an ill-merited windfall” and the purchasers would suffer “a harsh and excessive penalty for a comparatively trivial breach”. Mason J and Deane J, pp.449-450, held that relief against forfeiture where a purchaser was in breach of an essential condition would only be granted in exceptional circumstances, namely, unconscionable conduct on the part of the vendor in rescinding the contract. They found that the conversation with the clerk had contributed to the purchasers’ breach.

8. In some cases the Hong Kong courts have adopted the Australian approach (for example China Pride Investment Ltd v Silverpole Ltd [1994] 2 HKC 341). However, the strict approach was restored by Union Eagle Ltd v Golden Achievement Ltd [1997] 1 HKC 173 in which the Privy Council said that the Australian approach was unsuitable for Hong Kong because there was no need to overrule Steedman v Drinkle. If relief is necessary, the correct path is through estoppel or restitution. As noted in paragraph 5 above, however, equitable relief would only be granted in rare cases.

(2) The Wu Wing Kuen case

9. In Wu Wing Kuen at first instance ([1999] 3 HKC 310) the vendor was unable to produce in proof of title either the original power of attorney required under section 13(1)(c) of the Conveyancing and Property Ordinance or a certified true copy under section 13(2)(b). The purchaser argued that he was entitled to refuse to complete and claimed the return of his deposit. The vendor argued that secondary evidence was

permissible to prove title under section 13.

10. Recorder Robert Tang SC identified 12 cases on the question, half of which were for secondary evidence being available and the others against. The Recorder found for the vendor but noted that he did so with regret. The purchaser was unable to recover his deposit yet his legal adviser had no choice but to advise that, because of the uncertain state of the law, acceptance of secondary evidence may affect the title. The Court of Appeal upheld the Recorder and, as noted in paragraph 1 above, Godfrey J shared his regret that the purchaser was unable to recover his deposit.

(3) Other problem situations

11. The problem is not limited to proof of title. An important situation in the context of Hong Kong relates to contracts where time is of the essence (considered in “Tough on Purchasers?” (“TOP”), an article submitted to the Department of Justice by Myrette Fok, Associate Professor, School of Law, City University of Hong Kong).

12. In Union Eagle Ltd v Golden Achievements Ltd (cited in paragraph 8 above and in TOP, p.1) the contract stated that time was of the essence and required completion by 5:00 p.m. on the completion date. The messenger of the purchaser’s solicitor arrived with the balance of the purchase price at the vendor’s solicitor’s office at 5:10 p.m. The vendor refused to accept the narrowly late tender of the balance of the purchase price, rescinded the contract and the purchaser forfeited his deposit of \$420,000. The purchaser argued unsuccessfully, both in the Court of Appeal and in the Privy Council, for a broader equitable principle that relief from forfeiture should be granted in any case where it would be unconscionable for a vendor to terminate a contract for the sale of land.

13. In a dissenting judgment in Union Eagle in the Court of Appeal ([1996] 1 HKC 349, 361-362), Godfrey JA observed that the vendor did not purport to

terminate the agreement until after the purchaser had tendered the money; that the breach was slight, trivial and inadvertent; that the loss of the purchaser's equitable interest and deposit would be out of all proportion to the injury to the vendor; that this would be a windfall to the vendor; and that the vendor had suffered no prejudice whatever by reason of the purchaser's few minutes' delay. He added that, "If it is the common practice of vendors to seek to take advantage of a few minutes' delay by solicitors (or their messengers) to call off the bargains they have made with their purchasers, then it is past high time for this court to step in to put a stop to it."

14. Other cases noted in TOP (p.1) include Lee Kenny v Wong Kwok Yan [1994] 2 HKC 309 where the vendor's solicitor's failure to deliver a draft agreement within a reasonable time was held to have contributed to the purchaser's delay in signing an agreement, and China Pride Investment Ltd v Silverpole Ltd (see paragraph 8 above) where the vendor's delay in delivering in delivering a draft mortgage was held to have contributed to the purchaser's delay in completing. In Speedy Rich (Asia) Limited v Leung Pui Shu and Ho Yuen Yeuk (1999) HCt unrep HCA 3623/1997 (TOP, pp.2-3), it was held that it would be unconscionable to allow the vendors to rescind where there had been an agreement to vary some of the terms of the contract in circumstances which led the purchaser to believe that the vendor would not insist on the purchase money being paid by the time of completion stipulated in the contract (this was 1 p.m. on the day of completion; the vendor's solicitor confirmed by fax at 12:49 p.m. revised arrangements for the purchaser to inspect the property but was silent on the purchaser's solicitor's suggestion that completion be delayed until 3 p.m.; the vendor's solicitor notified the purchaser's solicitor at 1:15 p.m. that the vendors had rescinded the contract and forfeited the deposit).

15. TOP (p.7) also notes the difficulties posed for the purchaser by Hong Kong conveyancing practice under which most contracts provide expressly that time is of the essence. Equity's jurisdiction to grant relief from forfeiture is limited when the purchaser breaches an essential time condition. Further there is no statutory provision giving the court a discretion to return the deposit to a purchaser who is merely technically in breach. Accordingly, there is nothing to stop a vendor in Hong

Kong from taking advantage of a trivial delay by a purchaser even where the vendor has suffered no loss (for example, because of a rising market).

16. It is envisaged that the relief available under a provision similar to section 49(2) of the Law of Property Act would be carefully controlled by the courts and would not cover situations such as where purchasers default merely through a change of heart (for example, when prices fall) or because of financial problems (for example, loss of employment or profits). Cases such as Safehaven Investments and Behzadi, cited in paragraph 20 below, indicate that the courts would refuse unmeritorious claims for relief made by purchasers.

(4) The law elsewhere

England

17. Section 49(2) of the Law of Property Act 1925 provides, “Where the court refuses to grant specific performance of a contract, or in any action for the return of a deposit, the court may, if it thinks fit, order the repayment of any deposit.”

18. TOP (p.5) notes that section 49(2) was enacted in England to redress injustice in situations in which the purchaser was bound by the terms of his contract to accept property or title to property that differed substantially from his expectations. In these circumstances the court would not award specific performance to the vendor, but the purchaser, being technically in breach of contract, would be unable to recover his deposit (Scott v Alvarez [1895] 2 Ch 603, Beyfus v Lodge [1925] Ch 350, and Hall v Burnell [1911] 2 Ch 551).

19. In Universal Corporation v Five Ways Properties Ltd [1979] 1 All ER 552, 555, Buckley LJ endorsed the views of Megarry J in Schindler v Pigault (1975) 30 P&CR 328 who said that the jurisdiction under section 49(2) was to be exercised where the justice of the case requires and was not confined to cases in which one party’s conduct was unconscionable but was exercisable on wider grounds after considering the conduct of the parties, the gravity of the matters in question and the

amount at stake (TOP, p.6). Buckley LJ added, “I take the word ‘justice’ to be used in a wide sense, indicating that repayment must be ordered in any circumstances which makes this the fairest course between the two parties”.

20. In Dimsdale Developments (South East) Ltd v de Haan (1983) EGLR 1, Gerald Godfrey QC held that the justice of the case demanded that the deposit be returned to the purchasers because the vendors had made a profit on resale, although he required the purchaser to submit to a deduction because of losses to the vendor caused by the purchaser’s delay (TOP, p.6). In Safehaven Investments Inc. v Springbok Ltd (1996) 71 P&CR 59 the court refused an application for relief against forfeiture of the purchaser’s deposit, having found no misrepresentation on the part of the vendor as alleged by the purchaser and that the purchaser had persistently refused to provide information to the vendor required to meet a condition precedent under the contract. In Behzadi v Shaftesbury Hotels Ltd (1990) 62 P&CR 163, after finding that the vendor’s failure to deduce title by a certain date would not have prejudiced the purchaser, and that the purchaser’s requisition requiring it was unreasonable, the court refused to grant relief against forfeiture of the purchaser’s deposit.

21. In Michael Richards Properties Ltd v Corporation of Wardens of St Saviour’s Parish, Southwark [1975] 3 All ER 416, 425, Goff J held that, the parties having deleted “unless the court otherwise directs” from a clause in the agreement requiring forfeiture of deposit on failure by the purchasers to complete, an order under section 49(2) would be refused since the parties had agreed to the forfeiture and, further, the purchasers had deliberately refused to perform their part of the agreement. He did not, however, hold that the agreement excluded the jurisdiction of the court to make an order under section 49(2). In Country and Metropolitan Homes Ltd v Topclaim Ltd [1996] 3 WLR 525, 533, Timothy Lloyd QC observed that such a clause did not alter the ordinary position at law whereby if it was the vendor’s fault that the contract was not completed, the purchaser is entitled to the return of the deposit. Section 49(2) is needed only to enable a purchaser who is at fault to recover the deposit. In the interests of certainty, contracting out of any equivalent of section 49(2) introduced in Hong Kong should be restricted, since otherwise the provision

would likely prove to be meaningless (TOP, p.8).

Australia

22. Section 55(2A) of the New South Wales Conveyancing Act 1919 is identical to section 49(2) of the Law of Property Act.

23. In Lucas & Tait (Investments) Pty Ltd v Victoria Securities Ltd [1973] 2 NSWLR 268, 272, Street CJ noted that the courts had adopted a liberal approach to the jurisdiction conferred by the section in the sense that it conferred a wide discretion and it would not be right to impose a gloss on its scope preventing a purchaser from recovering a deposit in any case where a vendor has rescinded because of a repudiation by a purchaser. Nevertheless, a vendor who forfeits a deposit in strict enforcement of his legal rights is not to be deprived of it under section 55(2A) unless it is unjust and inequitable to permit him to retain it.

24. In Gogard Pty Limited v Satnaq Limited [1999] NSW 1283 (23 December 1999) (as described in a paper dated 31 January 2000 by John Morgans, Baker & McKenzie, submitted to the Panel by the Law Society) the court set out the factors to be weighed in determining whether relief should be granted under section 55(2A) –

- (1) The conduct of the parties, especially the applicant, the circumstances that brought about the termination and forfeiture, and the amounts at stake. The court considers matters connected with the contract as well as the conscionability of the conduct of the parties after the contracts are exchanged.
- (2) Whether the purchaser took a risk in structuring its financial dealings in such a way that, at the time when completion was to occur, the

purchaser was unable to finance the purchase.

- (3) Did the purchaser do everything in his power to complete, with the fault lying with the solicitors of the purchaser?
- (4) Would the purchaser have a defence to an order for specific performance if an order requiring such were sought by the vendor?
- (5) Was the deposit in the nature of a penalty?
- (6) Has the vendor resold the property to a third party for a higher price than that agreed between the vendor and the original purchaser: did the vendor seek, by the resale, to make a windfall profit at the expense of an innocent purchaser?

Arguments against introducing a provision equivalent to section 49(2)

25. Arguments against amendment include –

- (1) A provision equivalent to section 49(2) would interfere with the sanctity of contract and lead to unmeritorious litigation by parties seeking to renege on signed agreements.
- (2) Where there has been a breach of an essential term, such as time being of the essence, to allow the court to exercise discretionary power amounts to interference with the freedom of contract.
- (3) The use of discretionary power may jeopardise the certainty of contract in order to give justice in individual cases. The circumstances in which

the discretion should not be exercised should be specified.

- (4) The enactment of the Land Titles Bill may clarify the grey area regarding proof of title created by section 13 of the Conveyancing and Property Ordinance. The status quo should be maintained in the meantime.
- (5) It is common for vendors simultaneously to be purchasers in a second transaction and to rely on the deposit from the sale to complete the purchase. Should the deposit for the first transaction be ordered to be returned to the purchaser upon non-completion through no fault of the vendor, the vendor could face financial difficulties in completing the second transaction as a purchaser, and may even suffer the loss of his deposit if he cannot complete that transaction.

Arguments for introducing a provision equivalent to section 49(2)

26. Arguments for amendment include –

- (1) Hong Kong is one of the few common law jurisdictions in which there is no equivalent of section 49(2), nor does there appear to have been a plethora of litigation where such provision has been introduced (John Morgans, Baker & McKenzie, as cited in paragraph 24 above). Further, arguably, the current practice in Hong Kong leads to litigation since it leaves no room for even an insignificant, inadvertent, technical error by an innocent purchaser, while allowing the vendor to take a windfall profit that may amount to unjust enrichment (TOP, p.7, and the Hon Margaret Ng). The courts have shown that they are prepared to dismiss unmeritorious claims under section 49(2) (for example, Safehaven Investments and Behzadi as cited in paragraph 20 above).
- (2) Freedom of contract should not of itself prevent a remedy being available to prevent an actual injustice (the Hong Kong Bar Association).

The equitable jurisdiction to relieve from forfeiture is limited when the purchaser breaches an essential time condition and there is no statutory provision giving the court a discretion to return the deposit to a purchaser who is technically in breach. There is nothing in Hong Kong to stop a vendor from taking advantage of a trivial delay by a purchaser even where he has suffered no loss (TOP, p.7). As a matter of principle, relief from forfeiture should be given in circumstances where it will not cause injustice but will on the contrary prevent injustice.

- (3) Certainty of contract would not be jeopardised. The exercise of the discretion would involve a consideration of the interests of achieving justice between two parties to a particular contract, rather than the stating of a general rule (Judith Sihombing, Associate Professor in Law, Faculty of Law, University of Hong Kong, in a submission to the Department of Justice). Accordingly, there should be no specification of circumstances in which the discretion should not be exercised. The section was designed to provide relief to a purchaser against an unjust and inequitable consequence of forfeiture of a deposit and attempts to categorise such circumstances would tend to obscure rather than to elucidate the approach to the exercise of the statutory discretion (Street CJ in Lucas & Tait – cited in paragraph 22 above – pp.272-273). The jurisdiction to grant relief must be exercised in any circumstances which make this the fairest course between the two parties (Buckley LJ in Universal Corporation – cited in paragraph 19 above – p.555). The factors which the court will consider in the exercise of its discretion are made clear in cases such as these and Gogard Pty (cited in paragraph 24 above).
- (4) The problem of proof of title that may be resolved by the enactment of the Land Titles Bill is only one possible cause of injustice. As noted in subparagraph (3) above, it should be possible for the jurisdiction to be exercised in any circumstances in which the forfeiture of the purchaser's

deposit would be unjust and inequitable. A trivial breach of an essential time condition which causes the vendor no loss – and may enable him to make a windfall profit – is an important problem area in Hong Kong.

- (5) Arguably, a vendor who enters a second transaction as a purchaser would be within the scope of the second factor regarding the exercise of discretion set out in Gogard Pty (see paragraph 24 above). That is, he would be a purchaser who took a risk in structuring his financial dealings in such a way that, at the time when completion was to occur, the purchaser was unable to finance the purchase. In this situation, non-return of the deposit would be unfair to the purchaser in the first transaction who effectively is being asked to guarantee the risk undertaken by the vendor in the second transaction even in circumstances where it may be unjust and inequitable to forfeit his deposit. Further, in a situation where an essential time condition has been breached by the purchaser in a trivial and inconsequential way, it is unlikely that the vendor would suffer any loss in respect of the second transaction.
- (6) A vendor would not be deprived of the deposit under the provision unless it would be unjust and inequitable to permit him to retain it. Even where the vendor is not permitted to retain the deposit on those grounds, it is open to him, in appropriate cases, to seek such damages as may be payable to him by the defaulting purchaser in accordance with the established rules governing the measure of damages (Street CJ in Lucas & Tait – cited in paragraph 23 above – pp.272-273).

Recommendation

27. The Administration recommends that –
- (1) a provision equivalent to section 49(2) of the Law of Property Act be introduced by way of amendment to section 12 of the Conveyancing and Property Ordinance (which is based on section 49); and
 - (2) such amendment include an express prohibition against contracting out of the provision.

Consultation

28. A summary of the responses of consultees is annexed.

Legal Policy Division
Department of Justice
February 2001

Summary of the Responses of Consultees

The parties consulted

The following organisations were consulted on the proposal to give the court a discretionary power to return deposits, similar to that conferred on the courts in the UK under section 49(2) of the Law of Property Act 1925 –

- (1) The Judiciary.
- (2) The Law Society.
- (3) The Bar Association.
- (4) The Real Estate Developers Association of Hong Kong.
- (5) The Consumer Council.
- (6) The University of Hong Kong.
- (7) The City University of Hong Kong.
- (8) The Hongkong Conveyancing & Property Law Association Limited.
- (9) The Director of Lands
- (10) The Secretary for Planning and Lands.

Summary of responses

(1) Judiciary

2. The Judiciary is of the view that this is a policy matter and declined to take part in the policy formulation process as a matter of principle.

(2) The Law Society

3. The matter has been considered by the Property Committee of the Law Society on more than one occasion and also by the Council.

4. In both the Property Committee and the Council, after lengthy debate,

there was no consensus as to whether a change should be effected to provide the court with a discretion to order a return of the deposit to the purchaser.

5. Members are of the view that there are compelling arguments both for and against the proposal.

(3) The Hong Kong Bar Association

6. It is accepted that any attempt to interfere with the freedom of contract, upon which the survival of the Hong Kong economy depends, should be taken with care, and with thorough and mature regard to all relevant considerations. However, the sanctity of contract should not of itself be a reason for not addressing an actual or perceived potential injustice.

7. Although situations where the purchaser is in default and yet deserves to recover are likely to be rare or unusual, they are not impossible.

8. An amendment to codify the principles regarding the admissibility of secondary evidence of lost title deeds and documents in proof of title and the quality of such evidence would not address or address fully all the possible scenarios of unfair forfeiture of deposit in land-related transactions .

9. The common law rule against penalties or the court's overriding equitable jurisdiction to grant relief against forfeiture may not, in the absence of special circumstances, be of any use to mitigate the injustice of unfair forfeiture of deposit where what is involved is the conventional 10% deposit.

10. There is, therefore, a case for Hong Kong to adopt section 49(2) of the Law of Property Act 1925 to complete the range of remedies dispensable by the local court in cases arising from a sale or exchange of an interest in land. The qualification of the jurisdiction and discretion, other than with reference to what the court may think fit, is not recommended. The court is always at liberty to dismiss unmeritorious claims.

(4) The Real Estate Developers Association of Hong Kong

11. The Association expressed concern that the proposed granting of discretionary power to the courts would jeopardise the sanctity of contract and lead to much frivolous and unmeritorious litigation instigated by parties trying to renege on signed agreements.

12. It also takes the view that it is common for vendors simultaneously to be purchasers in a second transaction and would rely on the deposit from the sale to, in turn, complete the purchase. Should the deposit of the first transaction be ordered to be returned to the purchaser upon non-completion through no fault of the vendor, the vendor could face financial difficulties in completing the second transaction as a purchaser, and may even suffer the loss of his deposit on the second transaction.

13. Furthermore, the passing of the Land Titles Bill may remove the grey area created by section 13 of the Conveyancing and Property Ordinance. The status quo should be maintained in the meantime.

(5) The Consumer Council

14. The Council supports giving the court a power to return the deposit to a purchaser under special circumstances where it will cause injustice for the purchaser to lose his deposit through no fault of his own.

15. It is also suggested that the court's discretion should be qualified and the circumstances under which the discretion should not be exercised should be specified.

16. The Council indicated that it lacks the resources to explore exhaustively all the circumstances that warrant the exercise of such a power by the court.

(6) **The University of Hong Kong (Judith Sihombing, Associate Professor in Law)**

17. Professor Sihombing cautions that the exercise of discretion can be an unruly machine. Statutory provisions may not be the universal solution even though the results of similar legislation, in other jurisdictions, tend to be acceptable generally.

18. One problem with the proposed amendment is that there is no way to legislate for the manner in which a judge is to, or should, exercise discretion. Another problem is that the proposed amendment does not really address an incidental problem in the Hong Kong situation, namely the use of Provisional Agreements (PA) in transactions.

19. Professor Sihombing suggests that the best solution may be a two-prong approach – to legislate to allow the exercise of discretion in appropriate cases, and to review the effect of PA.

20. Other alternatives include –

(1) to legislate for the availability of a remedy such as restitution based on unconscionability thereby expanding contractual principles. This would be possible by extending the equitable jurisdiction where there is “fraud, mistake, accident or surprise” to cover those situations described as unconscionable, or as “sharp practices” in Hong Kong;

(2) to adopt the concept in New Equity, which is being developed in a line of Australian and New Zealand authorities, but Professor Sihombing has cautioned that it is probably too giant a step to take at one stroke.

21. It is also suggested that in conjunction with the introduction of the Land Titles Bill, there could be a wholesale review of the conveyancing contract and practice to eliminate those traditional, rigorous and sometimes harsh doctrines and rules which Hong Kong conveyancing has inherited from the English real property

law, bearing in mind the local circumstances and practices.

(7) The City University of Hong Kong (Myrette Fok, Associate Professor, School of Law)

22. Professor Fok's comments in her article "Tough on Purchasers?" are cited extensively in the main paper. She concludes that legislation in similar terms to section 49(2) would enable Hong Kong courts to exercise a discretion to return a deposit to a purchaser who is late for completion on wide grounds, including grounds that the vendor has suffered no loss and that the purchaser's delay was inadvertent. This could deter vendors from taking advantage of trivial breaches by their purchasers.

23. Professor Fok also submits that, without a restriction on contracting out, such a provision would likely prove to be meaningless in Hong Kong.

(8) The Hong Kong Conveyancing and Property Law Association Limited and its President Mr Leung Siu Hon

Views of the Association

24. The Directors of the Association are unable to reach a consensus on whether there is a need to amend the legislation to enable the court, of its own motion, to order repayment of deposits to purchasers.

Personal views of the President of the Association, Mr Leung Siu Hon

25. Mr Leung considers that the Court should be given the power to order refund of deposits in cases where the transactions fall through because of the complexity of the law; where the purchaser has come with clean hands; or where the vendor has resold the property at a gain; and in other cases following the factors, if any, to be laid down in the Ordinance.

26. He however suggests that the court should not have power to overrule express conditions of sale (for example, time of the essence clause) as it is unfair to the vendor.

27. The Australian provisions (section 55 of the New South Wales Conveyancing Act 1919) should not be followed but the factors set out in Gogard Pty Ltd v Satnaq Limited (1999) NSWSC 1283 (23rd December 1999) should be weighed in determining whether relief should be granted.

(9) Director of Lands

28. The department has no plans for reform but would be willing to participate in a working group, if any, on issues that may arise from consideration of the proposed amendments.

(10) Secretary for Planning and Lands

29. There are no existing plans to conduct reform in this area.

**Court's power under section 12 of the
Conveyancing and Property Ordinance (Cap. 219)**

**The Administration's response to comments made by the
Bar Association in paper dated 19th (Document 1), by
the Hon. Audrey Eu, SC in letter dated 20th February 2001 (Document 2)
and by the Law Society in letter dated 20th February 2001 (Document 3)**

Part A - Comments common to both Documents 1 and 2

Documents 1 (submitted by the Bar Association) and 2 (submitted by the Hon. Audrey Eu, SC) have the following common comments in support of their view that the courts of Hong Kong should not be conferred with a discretionary power to order the repayment of a purchaser's deposit similar to that provided in England and Wales under section 49(2) of the Law of Property Act 1925.

- (a) The occasions on which a purchaser may need to rely on the proposed discretion would be few (paragraphs 10, 14, 16 and 17 of Document 1, paragraphs 1 and 2 of Document 2). Vendors would only seek to terminate the contract and forfeit the deposit, hence subjecting purchasers to possible inequity, in rising markets (paragraphs 12 and 15 of Document 1). There is already clear law governing most situations.
- (b) Parties should enjoy freedom of contract and the courts should not intervene (paragraphs 10 and 11 of Document 1). It is important to have certainty of contract (paragraph 7 of Document 2).
- (c) The existence of such a discretionary power would encourage purchasers to litigate for the recovery of the deposit even on flimsy grounds (paragraphs 5, 6 and 19 of Document 1, paragraph 7 of Document 2).

Administration's response to Part A

- (a) Cases would be few

2. The Administration agrees that the cases in which it is appropriate for the courts to exercise the proposed discretion are likely to be few. As noted in paragraph 26(1) of the Administration's submission made to the Panel for discussion

on 20 February 2001 (the “Administration’s submission”), there does not appear to have been a plethora of litigation in other jurisdictions where such provision has been introduced. Relief against forfeiture where the purchaser was at fault would only be granted in exceptional circumstances. If the property market in Hong Kong maintains its present relatively static condition, the incentive for vendors to take a hard line on completion of transactions would be further reduced.

3. However, the fact that the forfeiture of a deposit may create injustice in few cases is no reason to deny a remedy in these cases. In the Administration’s view, the present law in Hong Kong regarding forfeiture of deposit does not deal satisfactorily with all situations in which injustice may occur. As noted in paragraphs 5, 6, 15 and 26(2) of the Administration’s submission, the jurisdiction of equity to grant relief from forfeiture is limited and there is no statutory provision giving the court a discretion to return the deposit to a purchaser where that would cause no injustice but would, on the contrary, prevent injustice.

(b) Importance of freedom and certainty of contract

4. The exercise of the discretion would involve a consideration of the interests of achieving justice between two parties to a particular contract. It would not create any general rule preventing the forfeiture of deposits. Under such circumstances, the likely effect on the concepts of freedom and certainty of contract, if any, would be small. Those concepts are no longer considered absolute, and there are many situations in which a remedy is available to prevent an injustice being caused by these concepts. The rationale of conferring judicial discretions by statute arises from the principle of public policy that in some areas of law (including contract) the inflexible application of rigid rules is not always adequate to produce justice (Burrows Statute Law in New Zealand (1992), p. 246).

5. Further, it is worth noting that most of the statutory discretions that have been conferred in contract law are applicable when a contract has broken down (as would be the case under the proposed discretionary power where the contract has been rescinded by the vendor because of the purchaser’s fault) and certainty has thus been

destroyed in any case: they are discretions to grant relief rather than discretions to vary the contract obligations (Burrows, p. 247).

6. One example of such a statutory discretion in Hong Kong is section 16 of the Law Amendment and Reform (Consolidation) Ordinance (Cap. 23) under which, in the case of a frustrated contract, the court may, if it thinks just in the circumstances, order a party who has received a valuable benefit under the contract to pay to the other party an amount reflecting the value of the benefit. The court may also allow a party who has incurred expenses before the discharge of the contract to retain or recover those expenses.

7. Similarly, under section 7 of the Control of Exemption Clauses Ordinance (Cap. 71), a contract term purporting to exclude negligence liability for financial loss or damage to property is subject to a requirement of reasonableness to be applied by the court. Further where a contract term purports to restrict negligence liability, a party's agreement to or awareness of it is not to be taken as indicating his voluntary acceptance of any risk.

(c) Purchasers encouraged to litigate even on flimsy grounds

8. As noted in paragraph 26(1) of the Administration's submission, the courts have shown that they are prepared to dismiss unmeritorious claims. The well-established English and Australian precedents would assist the Hong Kong courts in considering issues relating to the merits or otherwise of the claims. The existence of such a body of precedents would enable Hong Kong lawyers to advise their clients on the availability of arguable grounds for making claims. The Administration is of the view that practically speaking it is unlikely that parties would commence unnecessary legal action.

9. One could argue that any remedy in respect of injustice could be abused. But if one were to deny a remedy because of such a possibility, the courts could never do justice.

Part B - Comments in Document 1 only

10. The following comments were also included in Document 1 –
- (a) The fact that limited companies are often used to acquire properties would reduce purchasers' exposure to costs and encourage them to embark on unmeritorious litigation (paragraph 5).
 - (b) Since there is no summary procedure for property transaction-related cases in Hong Kong, litigation, especially where a lien on title is permitted in the meantime, would tie up the vendor's property and be unfair to him (paragraphs 4, 8 and 19).
 - (c) A discretionary power may be needed in the UK because the question of title to property there may be a difficult one whereas the same does not apply in Hong Kong (paragraphs 13 and 14).

Administration's response to Part B

- (a) Use of limited companies would encourage unmeritorious litigation

11. It is true that limited companies are commonly parties to many property transactions in Hong Kong. However, if the situation could be exploited in the form of unmeritorious litigation, these would already have occurred. For example, if a deposit is forfeited, the purchaser, could unmeritoriously seek equitable relief. Given this context, an increase in unmeritorious litigation is unlikely to occur.

- (b) Vendor's property may be tied up for some time

12. The contention that it is unnecessary and arguably unfair to tie up the vendor's title is a factor which the court would take into account with all other relevant factors. Furthermore, this would in any event occur where there is any dispute regarding the sale and purchase contract, and not necessarily because it was argued that the case is appropriate for the exercise of the proposed discretion. A case based solely on an unmeritorious ground is likely to be disposed of reasonably quickly.

- (c) Title to property a difficult question in UK but not Hong Kong

13. As can be seen from the decision in the *Wu Wing Kuen* case, which identified another 12 cases where similar issues were involved, proof of title in the Hong Kong property market is not free of problems. In the Australian jurisdictions,

where there is title registration, the courts have also been conferred with discretionary powers similar to those being proposed for the Hong Kong courts. In any event, as explained in paragraphs 11 to 15 of the Administration's submission, the problem is not limited to proof of title.

Part C - Comments in Document 2 only

144. The vendor has provided consideration for the deposit by losing the opportunity to sell the subject property from the time a provisional sales and purchase contract was entered into until the time of rescission or completion of the agreement and this should be taken into consideration (paragraph 6).

Administration's response to Part C

15. Where the market price has remained the same, the vendor could sell the property at no loss. His position would be the same as if the original transaction has been completed. Where the price has increased, the vendor would receive more from a subsequent sale. Where the price has dropped, the vendor will be entitled to claim for loss from the purchaser. The court, when deciding on the exercise, or otherwise, of the proposed discretionary power, will consider whether it would be unjust to require the vendor to return the deposit. The principal issue is not whether the vendor has supplied consideration for the deposit, but rather whether in all the circumstances of the case, it would be just or not for the vendor to retain the deposit or for the deposit to be returned to the purchaser.

Part D – Comments in Document 3

16. Document 3 (submitted by the Law Society) advises that the Administration's proposal is supported in principle subject to further review of the detailed provisions of the legislation and subject to the proposed discretionary power being narrowly drafted.

Administration's response to Part D

17. Pending consideration of any detailed amendments to the legislation that may be suggested, the Administration is of the view that the

recommendation in paragraph 27 of its submissions should be retained. As noted in paragraph 26(3) of the Administration's submissions, there should be no specification of circumstances in which the discretion should not be exercised. The facts of each case which require appraisal by the court may be complex and individual (Burrows, p. 246). Nevertheless, the English and Australian case law cited in the Administration's submissions (for example, Gogard Pty, at paragraph 24) provides clear guidelines for the court to weigh in determining whether relief should be granted under the proposed discretionary power.

Conclusion

18. The Administration therefore remains of the view that –
- (a) a provision equivalent to section 49(2) of the Law of Property Act be introduced by way of amendment to section 12 of the Conveyancing and Property Ordinance; and
 - (b) such amendments include an express prohibition against contracting out of the provision.

Department of Justice
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