

**Further Comments of the Hong Kong Bar Association
on the proposed
Amendment to Conveyancing & Property Ordinance
Provision for Refund of Deposit where a
Sale and Purchase Transaction has failed**

General

1. Since presenting the paper dated 19 February 2001, the Bar has now also had the benefit of reading:

(a) the response of the Hon. Audrey Eu dated 20 February 2001, (*LC Paper No. CB(2)921/00-01(02) issued vide LC Paper No. CB(2)1270/01-02(04)*)

(b) background paper prepared by the Legislative Council Secretariat dated 15 March 2002, (*LC Paper No. CB(2)1352/01-02(02)*)

(c) the paper prepared by the Legal Policy Division of the Department of Justice in February 2001 together with the summary of the responses of consultees, and (*Appendix I to LC Paper No. CB(2)1352/01-02(02)*)

(d) the Administration's responses to comments made by the Bar Association in paper dated 19 February 2001, the responses of the Hon Audrey Eu of 20 February 2001, and the Law Society in letter of 20 February 2001. (*Appendix II to LC Paper No. CB(2)1352/01-02(02)*)

While there are no doubt respectable arguments in support of the proposed amendment, the Bar is still of the firm view that there should not be any legislation to allow a purchaser to recover the deposit in the event of the contract for the sale of land being terminated in circumstances where under the existing law, the vendor would have been entitled to forfeit the deposit.

2. The Bar is fully endorsed the views expressed by the Hon Audrey Eu in her paper of 20 February 2002.

The Authorities – how the proposed legislation works in other jurisdiction reveals that the proposed legislation is not supportable

3. In the Bar's earlier paper of 19 February 2001, it has attempted to set out the law on the application of the Section 49(2) of the English Law of Property Act 1925 giving the Court the discretion to order the repayment of the deposit. The Department of Justice had also done the same in paragraphs 17 to 21 of its paper of February 2000. The English authorities do show that the Court has a very wide discretion and the best summary would appear to be that expressed by Megarry J in **Schindler v Pigault** (1975) 119 SL 273 that the power was not

confined to cases where the vendor's conduct was unconscionable but "was exercisable on wider grounds, including a general consideration of the conduct of the parties, the gravity of the matters in question and also **the amount at stake**" (emphasis added). Also as quoted by the Department of Justice, Buckley L.J. also said in **Universal Corporation v Five Waves Properties Ltd.** [1979] 1 All E.R. 552 "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.**" (emphasis added).

4. The Australian case of **Lucas & Tai (Investment) Pty Ltd. v Victoria Securities Ltd** [1973] 2 NSWLR 268 referred to in paragraph 23 of the Department of Justice's paper of February 2001 would appear to put the focus of the exercise of the power on whether it is unjust and inequitable to permit the vendor to retain the deposit. However the better view must be that this case did not decide that one should only look at the conduct of the vendor to decide whether it would be equitable or inequitable to permit him to retain the deposit. Whether it would be just to order the return of the deposit must also depend on the conduct of the purchaser and perhaps a lot of other circumstances. Hence the case is of little guideline to anyone who wants to find out whether the deposit is recoverable by a purchaser in any given circumstances.

5. The paper from the Department of Justice of February 2001 also refers to the Australian case of **Gogard Pty Ltd. V Satnaq Ltd.** [1999] NSWC 1283 and the factors considered by the Santow J in reaching his decision to refuse to exercise the discretion to allow the purchaser to obtain a refund of the deposit under Section 55(2A) of the Australian Conveyancing Act 1919. It is important to note that the factors considered by the Judge were merely factors applicable to the case before him, and the decision could not be regarded as having laid down any definitive guidelines for the exercise of the discretion under this kind of legislation. In fact, in our view, if one were to analyse the factors considered by Santow J., the inescapable conclusion is that the factors tending to support the exercise of the discretion are likely to cause a lot of uncertainties to the law and some of them are difficult to defend.

6. It is important to note that Santow J. started off by observing that the discretion given to the Court is a wide one. He adopted his own earlier observation in **Terry v Permanent trustee Australia Ltd.** (1995) 5 BPR 14 :

"This provision has been liberally interpreted. **It is not necessary that the court find inequitable conduct on the part of the vendor.** Rather, in the exercise of its broad discretion, the court should look at whether in all the circumstances it could be said that it is unjust and inequitable to permit the vendor to retain the deposit forfeited on termination."

Santow J. also referred to cases like **Wilson v Kingsgate Mining Industries** [1973] 2 NSWLR 713 where there Wooten J. observed that :

“It is no doubt important that the court should not adopt an attitude in ordering the return of deposits under s55(2A) which would weaken the proper function of a deposit in providing a sanction for purchasers treating the making and completion of a contract with due seriousness and good faith. On the other hand **there seems every reason to exercise the discretion in favour of a purchaser who was willing and anxious to complete, but lost his opportunity through the temporary inadvertence of those he had properly employed to act for him.**”

It would thus appear that in Australia, there is a very strong body of judicial opinion that in cases where it is the purchaser’s solicitors’ fault in not performing the contract, e.g. the solicitors had delayed in tendering the price to complete when they have all the money on account, then this would be a standard case for the court’s exercise of the discretion to order the vendor to repay the deposit to the purchaser.

7. In relation to the conducts of the parties, Santow J. also referred to decisions such as **Terry v Permanent Trustee Australia** (supra) where it was observed that “the conduct of the parties, especially the applicant, the circumstances which brought about the termination and forfeiture, and **the amount at stake**” were relevant consideration for the exercise of the discretion.

8. As a matter of principle, it is difficult to defend any legislation which would have the effect of depriving a vendor of the right to retain his deposit when the vendor’s own conduct is not at fault and cannot be said to be inequitable at all. It must be remembered that the Bar is concerned with the situation where by definition, the purchaser has committed such kind of breach of the contract that the law would allow the vendor to terminate the contract as a result of the purchaser’s breach. Without any fault or inequitably conduct on the vendor’s part it is difficult to justify why a vendor should be deprived of his right to retain the deposit. Certainly it would be unfair and illogical that the vendor’s right to retain the deposit would depend on the fortuitous circumstances of the purchaser he has dealt with.

9. In most sale and purchase agreements, the vendor and purchaser deal with one another at arm’s length and there is no enquiry whatsoever as to the personal circumstances of the purchasers, or as to how the purchaser is to arrange for his own finance, or as to which solicitors the purchaser intends to retain and the competence of the purchaser’s solicitors. Certainly there is absolutely no reason as

to why the vendor's right to retain the deposit should depend on whether the purchaser's solicitors have acted competently or not and yet at least on the Australian authorities, whether the purchaser's breach was due to his own fault or due to the fault of his solicitors would appear to play a very important role in the court's exercising this kind of discretion. In most cases, the contract will come to an end by the vendor's exercising his right to terminate the contract because of the purchaser's failure to tender the price within the contractual time, and often this happens because something has gone wrong in the purchaser's financial arrangement. But it is difficult to see why the vendor's right to retain his deposit should be in any way affected by how the purchaser would like to organize his own finance, a matter which the vendor has absolutely no control whatsoever. In so far as the amount at stake is concerned, this is directly linked up with the size of the deposit, which in turn would depend on the price of the property agreed to be sold. Certainly we are not talking about cases where the size of the deposit is such that the Court would consider it as a penalty and in the overwhelming cases, the deposit would be 10% of the consideration. To have legislation, which would allow the Court to take into account the amount of the deposit paid in deciding whether to order repayment of deposit would tantamount to introducing legislation which would allow different treatment to the rich and the poor.

10. Of the 6 specific factors that swayed Santow J. against exercising his discretion in favour of the purchaser before him, the first factor was that he found that the vendor had not acted unconscionably. But as it has been pointed out above, if there is such legislation giving the Court a discretion to order the return of the deposit, the fact that the vendor has acted unconscionably would only be a factor in favour of the exercise of the discretion but the unconscionable conduct is not essential to the exercise of such discretion. Furthermore, even without such legislation there is power on the court to give relief to unconscionable bargain in well-defined situations. If the situation does not fall within these well defined circumstances where the Court would give relief for unconscionable bargain, short of acts of breach of contract, or acts inducing the purchaser's breach of contract, it is difficult to see what other unconscionable conducts that should result in the Court's depriving the vendor of retention of the deposit. If the vendor's conduct is such that it amounted to a breach of contract, then, plainly under the existing law, the vendor cannot terminate the contract and forfeit the deposit, and the new proposed legislation is unnecessary. If the vendor's conduct is such that it induces the purchaser's breach of the contract, then under the existing law, the doctrine of estoppel will come into play and the vendor would not be allowed to take advantage of his own wrong to determine the contract. The case of **China Pride Investment Ltd. v Silverpole Ltd.** [1994] HKC 341 is a good illustration. There is no necessity to bring in any new legislation to redress the situation either.

11. The second factor relied upon by Santow J. was that it was the purchaser who took a risk in so structuring his financial arrangement that led to his

inability to make payment in time. In our view, it is difficult to see how the prudence or otherwise on the part of the purchaser in organizing his own finance should have any role in deciding whether the vendor should be allowed to retain his deposit. After striking a bargain with the purchaser and having duly performed his part of the bargain, how could it be just that the vendor's right to retain the deposit be dependent on the purchaser's own conduct?

12. The 3rd factor relied upon by Santow J was whether the purchaser had done all that he could to complete and whether the non completion was due to some fault of his agent or solicitors and was beyond the his control. As we have pointed out in paragraph 9, it is hardly just to have any legislation, which would make the vendor's right to retain the deposit dependent on which agent or solicitors the purchaser would choose to retain. If it is the purchaser's solicitors who are at fault, the redress of the purchaser would be against his solicitors.

13. The 4th factor relied upon by Santow J was that the purchaser would not have a defence to a claim of specific performance by the vendor. This is another way of saying that the purchaser was in breach of contract and has no equitable defence such as laches and acquiescence to a claim for equitable relief. By definition, the vendor is only entitled to retain the deposit under the existing law if the contract has come to an end because of the breach of contract on the part of the purchaser. Hence the only consideration left is whether there are any circumstances giving rise to an equitable defence to a claim of specific performance such as laches and acquiescence. An important element in most equitable defence is the delay on the part of the vendor. If this is a relevant consideration, this would mean that the purchaser's claim for refund of deposit under this proposed legislation would be stronger if he should wait for a longer period of time (because by then the vendor's claim for specific performance is more likely to be defeated by the equitable defences). It is difficult to justify any legislation that would encourage a person to delay in obtaining his relief.

14. The next factor taken into account by Santow J. was that the deposit forfeited was not a penalty. This is precisely a reason for saying that the proposed legislation is not necessary. The law is now well established that if the amount of the deposit is such that it is in fact a penalty, then the law is that the vendor is not allowed to retain any part of the "penalty" at all. Instead the vendor's remedy then is to recover what is his actual loss as damages.

15. The last factor taken into account by Santow J. was whether the vendor had resold the property to a 3rd party at a price higher than the contract price with the purchaser. Often this test is put thus : did the vendor seek by the resale to make a windfall profit at the expense of the *innocent* purchaser? However this way of framing the test is unfortunate and may be the source of a biased view on the desirability of the proposed legislation.

16. In a situation where one has to resort to legislation like section 49(2) of the English Law of Property Act 1925, the purchaser could hardly be glorified as “*innocent*”, because under the situation he must be the party guilty of a breach of contract. Nor is it right to glorify him as someone merely guilty of a “*technical*” breach because the law does not recognize any special status for a mere “*technical*” breach. In law the breach is either (a) a breach which would only have the effect of enabling the innocent party to damages and not to terminate the contract, or (b) a more serious breach which would enable the innocent party not only to damages but also, at his election, to terminate the contract. It is in this latter situation that we have to consider whether the vendor should be allowed to retain his deposit. Of course whether the breach is of such a nature that would enable the innocent party to determine the contract would depend on (a) the terms of the contract which is being contravened, and/or (b) the gravity of the act of contravention. Take the case of a short delay in the tender of the purchase price as an example; the vendor would be able to terminate the contract because the contract has provided that time is of the essence. If the parties have expressly contracted that time is of the essence, is there any reason not to give effect to the term simply because the purchaser is merely a little bit late? Surely it could not glorify the breach by merely calling the little delay as a mere technical breach.

17. No doubt the fact that since the termination of the contract the vendor has managed to resell the property at a higher price would often give rise to a sentiment that the vendor has made a windfall because he would then have got the full benefit of the deposit paid by the purchaser and also the additional profit from the resale. However, the rights between the vendor and purchaser must crystallize at a certain point of time, and the law is that their right must crystallize at the point of time of the termination of the contract. In fact it is difficult to pick any other point of time. In nearly every case where the vendor has obtained this kind of “windfall”, the vendor would only have resold after the termination of the contract. When the Court is to consider exercising its power under the proposed legislation, the contract must have been determined and hence in considering this windfall factor, the Court must necessarily be looking at the conduct of the parties since the determination of the contract.

18. The proposed legislation would put the vendor into a difficult situation. The problem would not occur if the property price has gone down. Assuming that the property price has gone up, if the vendor does not resell, then he cannot be said to have received a windfall, and the purchaser would not be able to rely on this non-existing or unrealized windfall in aid for his claim for the return of the deposit. In this sort of situation, the vendor would be well advised to at once commence litigation with the purchaser immediately upon the termination of the contract to ask for a declaration that the vendor is entitled to forfeit the deposit and once the declaration is obtained, then the matter would become *res judicata* and the

vendor can then resell without any risk of being ordered to repay the deposit to the purchaser. This could hardly be a desirable situation. It would unnecessarily encourage litigation. If the vendor is to hold on to the property without obtaining a declaration, for how long should he hold the property before the risk of a suit from the purchaser for the recovery of the deposit would be gone? Must he wait for 6 years before he can resell without the risk of being ordered to repay the purchaser the forfeited deposit?

19. In the circumstances, if one is to analyse the sort of factors to be considered by the Court in exercising the power granted by the proposed legislation, it is our view that the inevitable conclusion is that the proposed legislation is not supportable.

Comments on the Administration's Response of March 2001

Administration's Response to Document (1) & (2) /Parts A, B & C

20. The Administration appears to take it for granted that under the existing law there are cases where the vendor's forfeiture of the deposit would create an injustice (paragraph 3 of the Response). Yet there is a distinction between "hard cases" and cases of "injustice". In the context under discussion, whether it is a case of "injustice" would involve weighing up the positions of both the vendor and the purchaser. From the vendor's point of view, there is nothing wrong that he should be entitled to keep what he is entitled under the contract. Any change of the law to put a vendor at risk of being deprived of what he is entitled to under the contract would require strong justification. Even in **Wu Wing Kuen case** where the Godfrey JA strongly advocated for the introduction of the proposed legislation, the vendor's conduct could not be criticised. Even if it is thought that the purchaser had suffered a particular harsh treatment because his failure to complete was due to his solicitors having taken a popular but mistaken view of the law, it is a strong or even compelling argument to say that the vendor's position should not be affected by the view of the solicitors chosen by the purchaser. If the purchaser had instructed the same solicitors who acted for the vendor in his acquisition of the property, then the purchaser would not have taken the mistaken view of the law to refuse to complete. Even if it is said that the purchaser in **Wu Wing Kuen case** should as a matter of policy be granted relief, this is not a justification to legislate for a general discretion to be given to the Court a general power to order the return of the deposit.

21. Hong Kong is in a very special position when it comes to sale and purchase of landed property and litigation arising from it. In Hong Kong, landed property is being treated more like an ordinary commercial commodity. This is why in England, Australia and in fact in other common law countries, unless otherwise expressly stated, the presumption is that time is not of the essence in the

sale and purchase of land. However the position in Hong Kong and the common expectation of the Hong Kong people is just the reverse. In Hong Kong for the provisional sale and purchase agreements, just like any other contract for the sale of any other commercial commodity, the rule is that unless the contrary is expressed, time is of the essence. (see **Kwan Siu Man v Yaccov Ozer** (1998) 1 HKCFAR 343, 355D). There is no special power for the court to give any relief of forfeiture of deposit in the case of sale and purchase of any other commodities, including shares in a company holding landed property. There is no reason to give such power in the case of landed property.

22. We have no first hand statistics on litigation in other jurisdiction arising out of the Court's general power to order the return of deposit and we therefore cannot dispute the Administration's view that "there does not appear to have been a plethora of litigation in other jurisdiction where such provision has been introduced". However we doubt whether the experience in other jurisdiction where the attitude towards acquisition of real property is somewhat different from that in Hong Kong is of any real value in deciding how the Hong Kong purchasers would react to such provision. It must be pointed out that when it comes to property litigation, the experience in the last 15 years or so in Hong Kong is that the Hong Kong people are really litigious and the wave of litigation would sail very closely to the performance of the property market. Before October 1997, there were a lot of litigation involving the purchaser's obtaining specific performance against the vendors and experience did show that purchasers are quite willing to accept title without much investigation when the property prices had risen. The trend has reversed since October 1997. There were many cases where the purchaser tried to find any excuse not to perform the contract and to obtain the repayment of the deposit.

23. For reasons set out in the earlier paper of 19 February 2001 and in paragraph 18 above, we would consider that the proposed legislation would have the undesirable effect of encouraging unnecessary litigation.

24. The fact that in some cases there is justification as a matter of public policy to confer on the court discretion to grant relief or to redress what is conceived to be an injustice does not mean that the concepts of freedom of contract, respect for contractual bargains, and certainty of rights and obligations, are no longer important. For instance, the fact that the court is given a discretion to adjust the parties' rights and entitlement when a contract is frustrated is not a justification for giving the Court the same power to adjust the rights to the deposit in cases where clearly the purchaser was in breach. Likewise the control of exemption clause is based on a completely different public policy consideration. In this area under discussion where even the Administration would consider that cases involving the exercise of the power under the proposed legislation must be few, it is doubted whether there is enough justification from a public policy point of view

to cause an inroad into the common law position and at the same time at the expense of causing unnecessary uncertainties to the parties' contractual rights. To quote from Lord Bridge in **The Cikuma** [1981] 1 WLR 314 at 321 (which was endorsed by the Litton PJ in **Kwan Siu Man v Yaccov Ozer** (1998) 1 HKCHAR at 361):

“The ideal at which the courts should aim... is to produce a result such that in a given situation both parties seeking legal advice as to their rights and obligations can expect the same clear and confident answers from their advisers.”

The introduction of such discretionary power to order the repayment of deposit certainly would not be conducive to achieving this good aim.

25. The response made by the Administration in Part B missed the point. The use of limited companies as purchasers would no doubt reduce the risk exposure of those in control of the companies from an award of cost or possibly even damages for slander on title. However if the Court is given what appears on the face of the proposed legislation an unfettered discretion to order the return of deposit, then surely the proposed legislation would further encourage those using the companies as vehicles for their investment or speculation to litigate for the return of the deposit if it turns out that the bargains are bad ones.

26. Likewise the Administration's view that whenever the vendor and purchaser are in litigation over the contract of sale and purchase, it is likely that the vendor's property would be tied up, is not an answer to the point that the proposed legislation would give rise to more litigation between the parties and more instances of tying up the property unjustifiably. The Administration fails to appreciate that the practical result of having the proposed legislation is that whenever the purchaser would ask the court to exercise this wide jurisdiction to order the return of the deposit, it is virtually impossible that the matter could be dealt with summarily either by way of striking out or by the summary procedure under Order 86 or Order 14 as it is almost inevitable that there should be a trial for the court to weigh up all the circumstances which would often include the subjective purpose and intention of the parties in connection with their conduct. The net consequence is that the cases, which could otherwise be disposed of summarily, would proceed to trial. The vendor's property would be tied up for a longer period and the cost of litigation would increase.

27. The Administration's Response to Part C failed to take into consideration the fact that there must be a well-defined point of time where the rights and obligations of the parties must crystallize. In the case where a contract has terminated, it is difficult to see how this point of time should be anything other than the time of the termination of the contract. It could not be just that the rights

of the parties would depend on when the parties should choose to litigate or whether subsequent to the termination of the contract, the vendor has the fortune of being able to sell at a higher price.

Conclusion

28. The proposed legislation is an unnecessary inroad into the principle of freedom of contract and would introduce unnecessary uncertainty to contractual rights. There is no evidence of any real demand for such legislative intervention. Even though similar legislation exists in England and in Australia, it is not something that should be introduced to Hong Kong.

Dated this 4th April 2002.