

10 April 2003

Your Ref: CB1/BC/6/01

Miss Becky Yu
Clerk to Bills Committee
Legislative Council
Legislative Council Building
8 Jackson Road
Central
Hong Kong

Dear Miss Yu

Bills Committee on Companies (Amendment) Bill 2002

Thank you for your letter of 4 April.

In view of the written response of the Administration, we feel compelled to make the following observations for the consideration of the Honourable Members.

1. In paragraph 7 of the response, it is said that if a mortgagee of a legal charge proceeds to sell the property, it is possible that the mortgagee cannot assign the legal estate in the land to the purchaser. It is difficult to understand the basis of this statement:
 - (i) Prior to the enactment of the Conveyancing and Property Ordinance (“CPO”) a legal mortgage was effected by assignment of the mortgagor’s legal estate to the mortgagee.
 - (ii) This was abolished by the CPO. Section 44 of the CPO provides that after the commencement of the section, a mortgage of a legal estate may be effected at law only by a legal charge.
 - (iii) To enable the mortgagee under a legal charge to convey the legal estate of the mortgagor, section 53 of the CPO expressly provides that when a mortgagee sells under an express or statutory power of sale, the

assignment *shall* operate to assign to the purchaser the mortgagor's estate in the land.

- (iv) There can be no doubt that the mortgagee under a legal charge has power to assign the legal estate to a purchaser in exercise of an express or statutory power of sale.

2. In paragraph 8 of the response, an attempt was made to demonstrate that the question of protection of a bona fide purchaser for value without notice of a contravention of section 157H(2) *will not arise in reality*. The reasons given do not accord with what happens in practice:

- (i) In the vast majority of cases, mortgages in favour of banks are legal charges and:

- (a) they invariably contain an express power of sale;
- (b) even if there is no express power of sale, by virtue of section 51(1) of, and paragraph 8 of the 4th Schedule to, the CPO, there is implied in every legal charge a power of sale.

- (ii) As a general rule, banks do *not* apply to the Court for an order for sale:

- (a) If the property is subject to a tenancy to which the bank has consented, the bank will sell the property subject to the tenancy relying on its express or statutory power of sale.
- (b) If the property is self-occupied by the mortgagor, or is occupied by a tenant of the mortgagor for which no consent has been given by the bank, and possession cannot be obtained voluntarily, the bank will apply for an order for possession but *not* an order for sale. After possession has been obtained the bank will sell the property with vacant possession relying on its express or statutory power of sale.

- (iii) Solicitors acting for a purchaser from a bank in a mortgagee sale will look to see that there is an express or statutory power of sale, instead of demand a copy of the order for sale.

- (iv) Given the following factors, it would not be unreasonable for solicitors acting for a purchaser from a bank in a mortgagee sale not to be particularly concerned with section 157H:

- (a) The fact that the mortgage was executed in breach of section 157H(2) may not be apparent on the face of the documents. The names of the directors of the company may not appear in the mortgage at all. For example, the loan may have been made to
 - (1) a connected person, e.g. spouse or child or step-child or trustee of a director (see section 157H(9)); or
 - (2) a borrower company controlled by a director of the mortgagor company through nominees.
- (b) The following provisions in the Companies Ordinance suggest that the purchaser's interest will not, in any event, be affected:
 - (1) Section 157I(3)(b) provides that section 157I(2) (under which security provided in contravention of section 157H(2) shall be unenforceable against the company) shall not affect an interest in any property which has been passed by the company to any person by way of security provided in connection with any loan.
 - (2) Section 157I(5) provides that without prejudice to the foregoing provisions of section 157I, section 157H(2) shall not of itself invalidate any transaction entered into in contravention thereof.
- (v) It is not correct to say that it is likely that the bank will be aware that the property is unenforceable at the time it sells the property, for the following reasons:
 - (a) More likely than not, the bank is not aware that the mortgage may be unenforceable against the company by reason of a contravention of section 157H(2). If the bank had been aware of this fact, it would not have accepted the mortgage as security in the first place.
 - (b) The bank will, of course, demand payment of the loan before it proceeds to exercise its power of sale. It is unlikely, unless the company is in liquidation, that the company will dispute the enforceability of the mortgage. This is because the company (absent liquidation) is likely to be still controlled by the directors who authorised the mortgage in the first place. If the

mortgage is held to be unenforceable, the directors will become liable to the company by virtue of section 157I(4).

- (vi) Given that the bank and their legal advisors would not normally be aware that the mortgage is unenforceable by reason of section 157I(2), the statement that it is very unlikely that they will run the risk of deceiving the Court by concealing the fact that the mortgage is unenforceable when applying for an order for possession or order for sale is misleading.

It occurs to us that the Administration's understanding of the law and practice in this area seem to be at variance with those of the profession and the industry.

Yours sincerely

Louis Loong
Secretary General