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Bills Committee on
Building Management (Amendment) Bill 2005
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Bills Committee on Building Management (Amendment) Bill 2005

Matters Arising from Meeting on 14 June 2005

At the meeting of the Bills Committee on 14 June 2005, Members raised a number of questions during discussion of the papers submitted by the Administration. Below are the responses of the Administration to these questions.

Mechanism for Terminating the Appointment of Managers
[LC Paper No. CB(2)1885/04-05(01)]

Mechanism for Terminating the Appointment of Managers

2. Having considered Members' views, we propose that the

mechanism for termination of the appointment of managers under paragraph 7 of Schedule 7 to the Building Management Ordinance (BMO) shall apply to the first manager (i.e. the manager specified under the deed of mutual covenant (DMC)) and subsequent contract managers whose contract with the owners' corporation (OC) does not specify a termination mechanism at all. In other words, if the contract has already provided for a termination mechanism (regardless of the terms/requirements), then the contractual spirit should be upheld. We will introduce Committee Stage Amendments as appropriate.

3. As to the current threshold of 50% of shares of owners for terminating the appointment of the manager, Members may like to discuss the matter further having regard to the views of the deputations given at the meetings on 25 and 30 June 2005.

Deeds of Mutual Covenant

4. The Chairman asked whether all DMCs need to be approved by the Legal Advisory and Conveyancing Office (LACO) of the Lands Department. Consent to sell units in uncompleted developments (the Consent Scheme) and the approval of DMC (DMC clause) are two separate requirements under the lease conditions. The Government introduced the Consent Scheme in 1961. It applies where the land grant contains a clause which requires the developer to obtain the written consent of Director of Lands for sales of units in an uncompleted development. The Government first included a DMC clause in land grants in late 1985. However, not all newly issued land grants contain a DMC clause. Small house grants and grants for industrial or godown purposes or small scale residential developments, for example, do not contain a DMC clause. The LACO issued Guidelines and revised Guidelines for drafting of DMCs in 1989 and 1999 respectively.

5. Where the Consent Scheme did not apply, the Law Society of Hong Kong has introduced the Non-Consent Scheme to cover those cases. The Law Society has also issued a practice direction requiring its members to follow the guidelines issued by the Law Society in drafting DMCs for all developments under the Non-Consent Scheme and all completed developments in respect of which no DMCs have been entered into. In 2004, the Law Society extended the scope of the application of its DMC Guidelines to cover all developments where approval of DMCs is not required to be given by LACO. The followings are extracted from the Property Practice Direction No.A5 "Management of Buildings – Deeds of Mutual Covenant" issued by the Law Society on 6 April 2004 –

"A. Application

1. Under Practice Direction A5, members are required to follow the Guidelines issued by the Society in the drafting of DMCs ("DMC Guidelines") for the following types of developments:-

   a. all uncompleted developments under the Non-Consent Scheme; and

   b. all completed developments in respect of which no DMCs have been entered into.

2. The Council has resolved to extend the scope of application of the DMC Guidelines to cover all developments where approval of the DMC is not required to be given by the Director of Lands so that the drafting of all DMC in Hong Kong in the future will fall to be regulated by either the Government or the Society.

……"

6. A Member asked about the "reserved area" in some buildings. The DMC Guidelines issued by LACO of the Lands Department provide, amongst others, that –

> "The developer/manager may reserve the rights for itself, its licensees or other third parties to install or affix chimneys, flues, pipes or any other structures or facilities on or within the common areas provided that the written approval of the owners' committee (or OC if formed) is obtained prior to the exercise of such rights and that such installation shall not unreasonably affect the enjoyment of the development by the owners and occupiers. Any consideration received therefor shall be credited to the management account for the benefit of all owners." (Guideline No.5)
>
> "Subject to the provisions of the lease conditions and the DMC, the DMC may reserve the right for the developer to retain for his

own use part or parts of the lot unsold not being common areas ("the Retained Areas") provided that –

(i) the Retained Areas shall be clearly defined and identified in the DMC; and

(ii) the Retained Areas shall be allocated an appropriate number of undivided shares and management shares on a fair and reasonable basis, and the developer shall remain liable to contribute pro rata to management and other charges and payments.

Any use of the Retained Areas allowed to those who purchase shall be clearly specified as such in any sales brochure and pre-sale advertising." (Guideline No.6)

The same guidelines appear in the DMC Guidelines issued by the Law Society.

7. We have also conveyed to the Lands Department about Members' concern on the current provision in the DMC Guidelines issued by the LACO of Lands Department regarding the initial period of appointment of the first manager. While the current DMC Guidelines provide that the initial period of management by the first manager shall not exceed two years, the manager's appointment could actually continue after the initial period of two years unless the appointment had been terminated under paragraph 7 of Schedule 7. We will report to the Bills Committee on receipt of Lands Department's reply.

8. At the meeting of the Panel on Home Affairs on 8 April 2005, Members discussed the problems of buildings with more than one DMC and urged the Administration to consider solutions – one of which is to provide a mechanism for amendments to the DMC. We assure Members that we will study the problems in consultation with the Department of Justice, Lands Department and the Land Registry and report to the Panel on Home Affairs as soon as possible.

Right of Developer or Major Owner of a Building

9. Members asked whether the developer of a building is required to declare interests in the case that the building manager is his subsidiary company. There is a distinction between the meeting of the management committee and the general meeting of owners in this regard.

As a general rule, if the owner concerned (whether he is a major or minority owner) serves as a member of the management committee (similar to a shareholder of a corporation who is also a director), when he votes in a management committee meeting (similar to a meeting of the board of directors), he owes a fiduciary duty to OC for the proposition that the OC should take a certain course of action. He thus needs to declare or disclose any conflict of interests. However, at general meetings of owners (similar to meetings of shareholders), an owner (whether or not he is a member of the management committee and whether he is the major or minority owner) may exercise his property rights in his shares in his own interests as he owes no fiduciary duty to the OC and is just exercising his own right of property – i.e. to vote as he thinks fit. It follows that an owner who is also a member of the management committee (whether he is the major or minority owner) is not subject to the rule against conflict of interest and duty when voting as an ordinary owner[1].

10. As to whether the building manager is required to declare interests if he is a subsidiary company of the developer, since the manager is an agent/employee of the OC, he is under an equitable duty to secure the best interest of the OC. If it happens that he acts in favour of the developer (being its parent company) over or against the benefits and interests of the OC, he is required to avoid any conflict of interests unless he has obtained consent from the OC upon its declaring such conflict of interests.

11. Paragraph 7 of Schedule 7 to the BMO provides for a termination mechanism for the building manager. In 2000, the Legislative Council passed an amendment which introduced a new sub-paragraph 5A stipulating that only the owners of shares who pay or who are liable to pay the management expenses relating to those shares shall be entitled to vote in the resolution. So long as an owner of shares is liable (whether or not he is the developer or a major owner) to pay the management expenses relating to those shares, he will be entitled to vote in the resolution of termination of the manager.

Obligations after Manager's Appointment Ends

12. Paragraph 8 of Schedule 7 to the BMO provides that within two months of the date on which his appointment ends, for whatever reason, the manager must –

[1] See pp. 193-194 of P Lawton's "Meetings in Hong Kong, Their Law and Practice", Longman.

(a) prepare an income and expenditure account for the period beginning with the commencement of the financial year in which his appointment ends and ending on the date his appointment ended and a balance sheet as at the date his appointment ended;

(b) arrange for that account and balance sheet to be audited by an accountant or by some other independent auditor specified in a resolution of the owners' committee (if any) or, in the absence of any such specification, by such accountant or other independent auditor as may be chosen by the manager; and

(c) deliver to the owners' committee (if any) or the manager appointed in his place any books or records of account, papers, documents and other records in respect of the control, management and administration of the building that are under his control of in his custody or possession.

Failure to comply is a breach of contract for which the owners may seek civil remedy through legal actions.

13. There is precedent judgment on the above provision[2]. As this provision concerns mainly the transfer of documents/accounts from the previous manager to the management committee and the new manager, we consider that this is basically a contractual matter between the management committee and the manager that could be resolved by civil means and does not warrant the introduction of a penalty clause. That said, we are open to suggestion of introduction of a penalty clause in Schedule 7 to the BMO, in particular the new requirement under the amended paragraphs 3 and 4 for the manager to open a trust account or client account for the OC.

<u>Proposed New Section 29A – Protection of Members of Management Committee</u>
[LC Paper No. CB(2)1885/04-05(02)]

Good Faith vs Reasonable

[2] *The Incorporated Owners of Blocks F1 to F7 of Pearl Island Holiday Flats AND Fullwill Property Management Ltd* (LDBM 273/2000)

14. Some Members considered that the proposed new section 29A is too loose if members of management committee could escape liability simply when they have acted in good faith. Some Members suggested that we should require members of the management committee to act in good faith and also in a reasonable manner in order that they could exercise section 29A. As we have explained at the Bills Committee, the proposed new section 29A would not prohibit anyone from taking legal action against a member of a management committee. It only provides a statutory basis for the member concerned to apply for striking out of his name from the legal proceedings.

15. We have considered Members' views. We have no objection from the policy perspective to require members of the management committee to act in a reasonable manner for the purpose of the proposed new section 29A. Accordingly, members of the management committee would have to prove that they have acted in good faith as well as acted in a reasonable manner in order that they could exercise the proposed section 29A.

Statutory Duty of Individual Members of Management Committee

16. Some Members considered that the protection provided for members of management committee acting on behalf of an OC under the proposed new section 29A should be extended to cover the statutory duty of individual members of a management committee. Members specifically discussed the provision in paragraph 1(2) of Schedule 3 which requires the chairman of a management commit to convene a general meeting of the OC at the request of not less than 5% of the owners for the purposes specified by such owners with 14 days of receiving such request. According to case law[3], the responsibility to convene an owners' meeting under paragraph 1(2) of Schedule 3 rests with the chairman of the management committee and not the management committee. As such, the proposed new section 29A will not offer immunity and protection to the chairman under such circumstances.

17. We have considered Members' views. The proposal to extend the immunity under the new section 29A to cover personal obligations imposed on a member of a management committee (i.e. to the effect if the member is acting in good faith, he shall not be liable for any act done or default made by him in the exercise or performance of the powers or

[3] *胡桂容及廖廣海 訴 黃漢明* (LDBM 323/2002)

duties imposed on him by the BMO) raises both human rights and Basic Law concerns. The effect of the proposal is that there will be a procedural bar on an individual's right to institute legal proceedings before a court in civil matters and a restriction on the court's jurisdictions and powers. If the proposal is adopted, it will mean that an aggrieved party[4] under the BMO will not be able to obtain any relief in respect of the act or default of the member of the management committee if the latter could claim that he is acting in good faith. Because the act concerned is related to a statutory duty imposed on the particular member, neither could the aggrieved party obtain any relief from the OC. That will leave the aggrieved party with no access to the court to have his claim determined.

18. As explained at the Bills Committee meeting[5], if a member of a management committee has contravened the law, thereby resulting in being convicted of an offence, then it will be extremely hard for him to seek protection under the proposed new section 29A against a claim because he was unlikely to be acting honestly. Section 44(2) of the BMO stipulates that a failure on the part of any person to observe any Code of Practice shall not of itself render that person liable to criminal proceedings of any kind but any such failure may, in any proceedings whether civil or criminal including proceedings for an offence under the BMO, be relied upon as tending to establish or to negative any liability which is in question in those proceedings. The Code of Practice issued under the BMO[6] has somehow offered a defence for members of management committee through the evidential aspect to exonerate their personal liabilities.

19. There is case law[7] showing that the court, when deciding whether the chairman or any member of a management committee or any particular owner should be held personally liable[8], will take into account different factors. As to paragraph 1(2) of Schedule 3 regarding the responsibility to convene an owners' meeting, whilst there is case law[9] ruling that the responsibility rests with the chairman of the management

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[4] In the case of paragraph 1(2) of Schedule 3, the 5% owners who requested the chairman to convene an owners' meeting.

[5] See paragraphs 11 and 12 of LC Paper No. CB(2)1885/04-05(02).

[6] The Code of Practice on Procurement of Supplies, Goods and Services provides that the chairman, secretary or treasurer should keep the two keys of the tender-box. The Code also requires members of a management committee to disclose in writing any pecuniary interest that they may have in any tender or contract considered or to be considered by the management committee or the OC.

[7] *葉大永建築師有限公司 對 金明閣業主立案法團及黃文賢* (CACV 143/1999)

[8] Section 17(1)(b) of the BMO stipulates that execution to enforce a judgment or order made against an OC may issue, with leave of the tribunal, against any owner.

[9] *胡桂容及廖廣海 訴 黃漢明* (LDBM 323/2002)

committee and not the management committee, there are also precedent judgments[10] showing that the court will take into account different factors in the context of the particular facts of the case when deciding whether the chairman has breached the law.

Misinformation from Building Manager

20. Members asked about the situation where members of a management committee have contravened the BMO requirements because of misinformation received from the property management company. The manager may be in breach of his contract with the OC if he fails to comply with the contractual terms relating to provision of advice in discharge of his management duties. Apart from contractual obligations, there is a general duty imposed on the manager to exercise due care and skill. If the manager, being an agent of the OC, acts in breach of this duty, he is liable in the law of tort for negligence. The degree of care and skill depends on the type and nature of agent. Therefore, in performing his duty, the manager must exercise the care, skill and diligence which is usual or necessary or proper in the type of work or business, i.e. building management in which he is employed. Hence, if the OC is ill-advised by the manager and the facts can establish a case of negligence against the manager, it is legally possible for the OC to sue the manager and seek appropriate remedy.

(Mrs. Angelina Cheung)
for Director of Home Affairs

[10] In*梁淑兒AND鄭沛濂* (LDBM 268/2003), the judge ruled in favour of the chairman of the management committee with respect of paragraph 1(2) of Schedule 3 to the BMO. The judge was of the view that the chairman was entitled to satisfy him generally that the requests of the 5% owners comply with the statutory requirement. While the judge considered that it was not appropriate for him to lay down any principles for the verification process a chairman should undertake and all depends on circumstances, in the case concerned, he considered that the chairman had every reason to embark on the process of verification as the application from the 5% owners contained a conspicuous error that certainly tainted the authenticity of all the requests. In*顏偉國 訴 何蘭及嘉都大廈業主立案法團* (LDBM 173/2000), the judge also commented on paragraph 1(2) of Schedule 3. The judge considered that the term "convene" did not mean formally holding the meeting, but only meant the issuance of the notice of meeting. The judge further stated that paragraph 1(2) of Schedule 3 did not require the chairman of the management committee to include in the agenda the resolution, word by word, as proposed by the 5% owners.