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16 May 2008

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Hon. Margaret Ng
 Chairman of the Bills Committee on
 Statute Law (Miscellaneous Provision) Bill 2008
 Legislative Council Building,
 8 Jackson Road,
 Central, Hong Kong.

Dear Margaret,

**PART 6 OF THE STATUTE LAW (MISCELLANEOUS PROVISIONS) BILL
 2008 – Proposed Amendments to the Conveyancing and Property Ordinance
 (Cap.219) – Production of Original Pre-intermediate Root Title Documents**

We refer to the Bills Committee meeting on 2 May 2008 and write to follow up on the issues discussed at the meeting:

Third Party Interests

The purpose of the proposed legislative amendments under Part 6 of the Bill is to provide that a vendor will not be required, as part of his duty to "give" title, to produce to the purchaser the originals of pre-intermediate root title deeds and documents relating exclusively to the property being sold.

S. 13A(4) is a "savings" provision the effect of which is that the purchaser will take the land subject to any valid and enforceable third party rights arising from the deposit of the "document" with that person which, under the general principles of land law in Hong Kong, have priority over the purchaser's title in that land or are binding on the purchaser.

We understand that the Bills Committee has concern on the effect of the proposed new S.13A(4) on purchasers and noted the Bills Committee's wish to expand the subsection to provide generally that nothing in S.13A shall affect the right or interest of third parties.

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As requested, we attach at the Annex the relevant extract from Senior Counsel's Advice, giving an analysis of the kind of third party interests that the purchasers may be subject to under S. 13A(4). We have to explain that the Senior Counsel's Advice was prepared at a time when the legislative proposal put forward is to the effect that neither the vendor nor the purchaser will be affected by any third party interests arising out of the non-delivery of original pre-intermediate root title documents and Senior Counsel's Advice should be read in that context. The legislative proposal has subsequently been changed so that instead of depriving any interests of the third parties, the purchaser will take subject to the common law interests of relevant third parties. Although there has been a change in the legislative proposal, Senior Counsel's Advice is still relevant to the extent it identified the kind of third party interests that the purchaser may be subject to under the new S.13A.

We consider the risk of a purchaser acquiring a defective title by reason of the existence of third party rights in or against the land as a result of the operation of the new Section 13A to be very remote, for the following reasons:

- (1) the sort of third parties whose rights would be relevant would be equitable mortgagees by way of deposit of title deeds. However, it is a fact that most mortgages in Hong Kong are effected by way of written legal or equitable charges, and equitable mortgages by way of deposit of title deeds are rare and not commonly encountered in Hong Kong.
- (2) In order to bind the purchaser, the relevant equitable mortgage must have been created before the date of an acceptable intermediate root of title which has to be at least 15 years old (assuming that the relevant Government lease is more than 15 years old). This is because the new Section 13A of the Ordinance still requires the vendor to deliver to the purchaser the original of an acceptable immediate root of title as well as further title deeds and documents created subsequent to the date of the intermediate root of title. Thus, one is talking about a situation where the equitable mortgage is at least 15 years old, the debt secured by the equitable mortgage is still outstanding and the equitable mortgagee has not, in the meantime, taken enforcement action against the land in question (as may be revealed, by example, by the registration of a *lis pendens* in the Land Registry against the land).
- (3) Moreover, an acceptable intermediate root of title has to be an assignment, a mortgage by assignment or a legal charge each dealing with the whole estate and interest in the land, by virtue of Section 13(1)(a)(ii) of the Ordinance. On the assumption that the assignment, mortgage by assignment or legal charge was a bona fide transaction, it is reasonable to assume that, in normal circumstances, the assignee, mortgagee or chargee named in the relevant instrument would have taken steps to satisfy himself that there was no hidden equitable mortgage by way of deposit of title deeds which might affect the land.

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- (4) The confluence of all these preconditions, each of which is unlikely to occur individually, makes the cumulative scenario an extremely remote possibility.
- (5) Although the purchaser's right to title documents upon completion is cut down, a purchaser's right to raise requisitions on pre-intermediate root title and refuse completion on discovery of title defects, whether pre-intermediate root or post-intermediate root, will not be affected by the proposed legislative amendments.

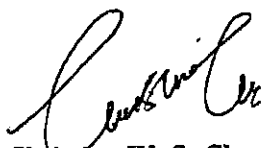
We confirm we have no objection to the Bills Committee's suggestion to expand S.13A(4).

Transitional Provision

We agree that the new law should apply to transactions being entered into after the enactment of Part 6 of the Bill.

We hope the above helps to clarify the legislative proposal in Part 6 of the Bill. We would like to thank the Bills Committee for being appreciative of the importance for Part 6 to be passed into law within this Legislative Council term and we stand prepared to render any further assistance on this subject as the Bills Committee may require.

Yours sincerely,



Christine W. S. Chu
Assistant Director of Practitioners Affairs

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ANNEX**Extract from Senior Counsel's Advice**

70. Because of the land registration system in Hong Kong, the priority of any right or interest over land which is *registrable under the LRO* is governed by the provisions of the LRO. As the land registration system created by the LRO is one of documents registration, only documents are registrable under the LRO. Accordingly, rights and interests that are not created by documents but, say by operation of law, are unregistrable.
71. As the proposed legislative amendments do not in any way affect the operation of the LRO, where the third party's right or interest is one which is registrable under the LRO, it will not be affected by the proposed legislative amendments. The provisions of the LRO will continue to govern the priority of such registrable right or interest.
72. Thus, any third party's interest which is registrable and has been duly registered with the Land Registry under the LRO will not be affected by the proposed legislative amendments as the priority of such registered interest is, and will continue to be, governed by s.3(1) of the LRO.
73. Where the third party's interest is registrable but is *not* registered, s.3(2) of the LRO will continue to operate and generally, subject to

fraud, such unregistered interest is void against a subsequent purchaser even with notice (see, s.4 of the LRO). That is the position under the existing law and will not be changed in any way by the proposed amendments.

74. Nothing in the proposed legislative amendments will affect the operation of the LRO. Registrable interests of third parties are thus not affected and their priority will continue to be governed by the LRO.
75. What about unregistrable third party rights or interests?
76. In Hong Kong, the priority of the rights and interests over land which are not registrable under the LRO are governed by the rules of common law and equity. "As a rule, both at common law and equity, where there are competing interests in property, they will rank for priority according to their order for creation (*Cave v. Cave* [1980] 15 Ch.D.639)". This is however subject to one important exception, namely, the well-known doctrine of bona fide purchaser without notice (see, the discussions in *Emmet and Farrand on Title*, 19th ed., at para.5.141.). The effect of the doctrine is that a bona fide purchaser for value of a legal estate generally takes free from all existing equitable interests of which he has no notice (see, *Pilcher v. Rawlins* [1972] 7 Ch App 259).
77. Conceivably therefore, insofar as the proposed amendments may alter the operation of the common law doctrine of bona fide

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purchaser without notice, the priority of some existing third party interests (that are equitable in nature and unregistrable under the LRO) may be affected.

78. But what are those third party interests which may be so affected? To answer that question, one would have to analyse the ambit of the proposed amendments.
79. As pointed out above, the only change that the proposed amendments make to the duty of the vendor is to relieve him from delivering to the purchaser pre-root documents. Under the new law as proposed, on completion the vendor would no longer be required to hand over original documents that are not required for proof of title. These are generally pre-root documents which are not required for proof of title by virtue of s.13 of CPO. Hence if those pre-root documents are in the possession of a third party, and if such possession could give rise to some equitable right or interest in the property in favour of the third party, the proposed legislative amendments may potentially affect such third party right or interest.
80. As the proposed change of the law is limited only to cutting down the title documents that are required to be delivered on completion, any third party rights or interests that do not arise from possession of title documents would not be affected in any way.
81. It follows from the above analysis that we can narrow down the nature of the third party interests that may be potentially affected by

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the proposed amendments. To be so affected, the third party right interest must satisfy *all* of the following requirements :

- (a) . the third party right or interest must be unregistrable under the LRO. Accordingly, it must not be a right or interest that is created by a document registrable under the LRO;
- (b) the third party right or interest must be an equitable interest. If it is a legal interest it is not subject to the doctrine of bona fide purchaser without notice at all, and whether the subsequent purchaser has notice of the third party interest or not would become irrelevant;
- (c) the third party right or interest must arise from his being in possession of the title documents; and
- (d) those title documents possessed by the third party must be documents that are not required for proof of title.

82. It should be clear, following the analysis above, that the third party rights which may be affected by the proposed legislative amendments are necessarily very limited. Indeed, the only type of third party right or interest that would satisfy all the requirements set out in paragraph 81 above would seem to be that of an equitable mortgagee whose interest arises from the deposit of the title deeds with him. That is also the only type of third party interest mentioned in the **Yiu Ping Fong** case by Yuen J.

83. Moreover, in order to be affected by the proposed amendments, the equitable mortgage should normally be one which was created *before* the intermediate root of title. This is because the proposed amendments would not relieve the vendor from delivering to the purchaser the original title documents which are required for proving title. Accordingly, normally speaking, only the equitable mortgages that were created in favour of third parties before the intermediate root would be affected by the proposed amendments. That would make the impact on third party rights even more limited.
84. The above analysis may be tested by some examples.
85. The rights of a mortgagee by deed made (whether made before or after the intermediate root) would not be affected by the proposed amendments. The mortgagee's rights being rights created by the deed are registrable in that the deed is a registrable document under the LRO. If it is registered, its priority falls to be governed by s.3(1) of the LRO. If it is not, s.3(2) applies. Nothing in the proposed amendments would affect the operation of the LRO in this respect.
86. Let us then take the examples of third party's interests mentioned in §43(3) of the Draft Consultation Paper prepared by the Department of Justice. In that paragraph, the Department of Justice mentioned the cases of third party's rights to set aside fraudulent transactions,

rights resulting from constructive trust, and rights by reason of breach of trust by administrators or executors.

87. The third party's rights in these cases are of course not registrable. But plainly they are not rights that would be affected by the proposed legislative amendments. None of these rights are rights that arise from the possession of title deeds by third parties. The rights of these third parties have nothing to do with title deeds and *ex hypothesi* cannot be affected by the proposed amendments.
88. Take for example the interest of a third party who is the beneficiary of a resulting or a constructive trust which is not registrable under the LRO. Whether or not the subsequent purchaser is bound by the interest of the third party would depend on whether he has either actual or constructive notice of the same. If, for example, the subsequent purchaser has notice of the fact that the third party is in actual occupation of the property, the subsequent purchaser would be regarded in law as having constructive notice of his interest (see, **Wong Chim Ying v. Cheng Kam Wing** [1991] 2 HKLR 253). Such third party rights or interest will not be effected by the proposed legislative amendments at all. This is because such third party rights or interest have nothing to do with title deeds, and certainly do not arise from the third party's possession of title documents. Moreover, the draft ss.13A(3) would not prevent constructive notice from being imputed to the purchaser in these circumstances. Nothing in the proposed amendments would alter the existing law regarding constructive notice of third party's rights

except to the very limited extent as provided in the proposed s.s.13A(3) which only deals with constructive notice arising from the non-delivery of pre-root title deeds and nothing further. The purchaser's notice of an occupier in actual occupation of the land will continue to give rise to constructive notice of the occupier's interest in the ordinary way.

89. I hope it is clear, following from the above analysis, that only a third party's interest the creation and continual existence of which necessarily involves his being in possession of title documents could conceivably be affected by the proposed legislative amendments.
90. As pointed out above, it would appear that the only kind of third party's interest that would fit into all the requirements mentioned above is that under an equitable mortgage arising from the deposit of title deeds with a third party. And for reasons mentioned in paragraph 83 above, to be affected by the proposed amendments, such equitable mortgage would normally have to be created *before* the intermediate root of title.
91. We are thus concerned only with a very limited class of third party interest. What is the impact of the proposed legislative amendments on such equitable mortgages?

Assessing the impact on equitable mortgages

92. In today's Hong Kong, it is extremely rare to find any equitable mortgage to be created by way of deposit of title deeds, a fact which I believe the Department of Justice agrees (see §51 Draft Consultation Paper). Equitable mortgage rarely exists in a commercial context, as it affords the equitable mortgagee neither adequate protection nor ease of enforcement. While it is not possible to rule out the possibility of there being some equitable mortgages created as a kind of domestic arrangement, the number of such equitable mortgages, even in a domestic context, must also be very small.
93. More importantly, as has been pointed out before, the proposed legislative amendments only have the effect of abrogating the rights of the purchaser to be delivered pre-root documents. Hence, in any case where the equitable mortgage is created within the TG Statutory Period, the vendor would not be able to take advantage of the proposed legislative amendment as he would not have original documents for the TG Statutory Period to enable him to meet the reduced requirement for the giving of title.
94. For equitable mortgages that were created before the TG Statutory Period, necessarily they are old. In most cases any claim under such equitable mortgages are likely to have been time-barred already (see s.7(2) of the Limitation Ordinance). However, as the Department of Justice has rightly pointed out, since the 12 years

limitation period only starts to run from the time when the third party's right of action accrues, it is possible that the right of action may not accrue until many years after the deposit of title deeds. For example, it is of course possible for X to have lent money to Y and obtained an equitable mortgage from Y (who deposited title deeds of his property with X). It may be that the term of the loan was that the same was only repayable in 10 years. In such a case, A's right of action would only arise 10 years after the deposit of title deeds. The limitation period of 12 years would only start to accrue when Y failed to repay after 10 years. In such a situation, A's action would only be time-barred 12 years after the accrual of his right of action: in other words, his right of action would only be time-barred 25 years after the deposit of title deeds by Y with X.

95. So how likely is such an equitable mortgage, i.e. one which is created before the intermediate root and still not yet time-barred, to be affected by the proposed legislative amendments? In my view, extremely unlikely.

96. Going back to the example given in paragraph 94 above, if Y were to sell his property any time after he had deposited the titled deeds with X, he would not have any documents of title to pass to his purchaser at all. The proposed legislative amendments would not help him as he would still not be able to provide the original documents to the purchaser for the TG Statutory Period. No purchaser properly advised would have agreed to complete the transaction. And if a purchaser should nonetheless complete in

such circumstances, he would not be able to obtain the property free from the equitable mortgage in favour of X as he will necessarily be fixed with constructive notice arising from the fact that the original documents within the TG Statutory Period have not been provided to him.

97. I note that in §43(1) of the Draft Consultation Paper, the Department of Justice puts forward a scenario of a mother who obtained an equitable mortgage from her son for her loan made to her more than 15 years ago. The equitable mortgage was created by the son depositing title deeds of his property with the mother. The son then sold the property to A who then waited for 15 years before selling the property again to B. As the sale by A to B took place more than 15 years after the sale by the son to A, the intermediate root of title would be the assignment from the son to A. Thus when A sells the property to B, on the proposed legislative amendments, A would not be required to produce to B the original title documents before the intermediate root of title, i.e. before the assignment from the son to A. The Department of Justice wondered whether in such a scenario, the interest of the equitable mortgagee, i.e. the mother, would be defeated unfairly.
98. This example given by the Department of Justice is a very clever one. For it is very difficult to think of any other situation where an equitable mortgagee could conceivably be prejudiced by the proposed amendments. But even on this scenario, the perceived risk of the interest of the mother being unfairly prejudiced is in my

view more theoretical than real. It would indeed be helpful to test this interesting example put forward by Department of Justice against the various points discussed above.

99. Firstly, as pointed out before, equitable mortgages are rare even in domestic situations. A mother who is so concerned to obtain a valid security of her loan to her son would probably want to make sure that a legal mortgage would be obtained. If she understands the law so well as to know that she could obtain an equitable mortgage by way of deposit of title deeds, chances are that she would want to have a legal mortgage properly prepared to give her a better security.
100. Secondly, and this is much more important, unless in the scenario put forward, the son has conspired with A, it is difficult to see how the son would have been able to successfully sell the property to A in the first place. Remember that at the time when the son sold the property to A, he had no title documents at all – his mother had them. How then could the son have sold the property to A unless A was some kind of an accomplice to him? No bona fide purchaser would have completed the purchase from the son if the son had not title deeds at all to complete the sale.
101. Accordingly, if A was an innocent independent purchaser, the scenario postulated in §43(1) of the Draft Consultation Paper would not and should not occur.

102. On the other hand, if A was an accomplice of the son, and the whole point of the scheme was to create an intermediate title so that after 15 years A could then sell the property without having to provide to the purchaser (i.e. B) the original documents deposited with the mother, I would say that such a scheme would be most unlikely in practice. It is most unlikely because under the proposed legislative amendments A would have to wait for the full TP Statutory Period (15 years or more) in order to reap the fruits of such a scheme.
103. Indeed, in the example under discussion, when the son and A conspired together they must have such uncanny foresight to be able to foresee that the law would be changed in the way of the legislative amendments presently proposed! (I would add, for completeness sake, that in about 12 years' time Hong Kong will have a registered title system. If the proposed amendments are to be enacted into law, anyone seeking to adopt a scheme as the one put forward in the example above will not have time to wait for 15 years for the scheme to bear fruit as the law will have been completely changed when the daylight conversion kick-in in about 12 years time from the commencement of the Land Titles Ordinance, Cap.585: see, s.24 and Part 2 of Schedule 1 of the Land Titles Ordinance).
104. If the son was prepared to commit fraud to cheat his mother out of her security, realistically there are better ways to commit a fraud than to engage in such an inefficient and cumbersome scheme. A fraudster could simply make a false statutory declaration of loss of

title deeds and complete by providing certified copies of documents obtained from the Land Registry. Thus, in the example under discussion, it is almost inconceivable that the mortgagor-son would have taken the trouble and expense of engaging an accomplice (being purchaser A) and to wait for 15 years in order to defraud his equitable mortgagee mother when he could have carried out his fraud simply by making a false declaration of loss of all title deeds. If the son were to make a false statutory declaration of loss, then with or without the proposed legislative amendments, the equitable mortgagee's (i.e. the mother's) interest is likely to be overridden by the subsequent purchaser who buys the property relying on the declaration of loss and hence without notice of the interest of the equitable mortgagee. Neither the existing law nor the proposed legislative amendments could prevent fraud of this kind.

105. Such deliberate frauds (including the making of false statutory declarations) are difficult to guard against and pose an inherent risk to any system of law and to any legislation. The proposed legislative amendments, like any other law, are of course not wholly immune from fraud. Such fraud has to be dealt with under the criminal law. What is important is that the proposed legislative amendments will not by themselves provide the means for an equitable mortgagor to defraud the equitable mortgagee.
106. Testing the proposed legislative amendments against the scenario put forward in §43(1) of the Draft Consultation Paper serves to illustrate how unlikely the proposed legislative amendments will

have any effect on an equitable mortgage that was created before the intermediate root of title. In my view, the impact of the proposed legislative amendments on third party rights is minimal.