

For discussion
on 19 December 2008

LEGISLATIVE COUNCIL PANEL ON DEVELOPMENT

Amendments to Land Titles Ordinance

PURPOSE

This paper reports progress on the preparation of the amendments to the Land Titles Ordinance (Cap. 585) (LTO) and seeks Members' views on the proposed amendment to the schedule under the Trading Funds Ordinance (Cap. 430) (TFO) to allow the Land Registry (LR) to operate the title registration system in future and make other service improvements.

BACKGROUND

2. When the LTO was enacted in July 2004, commencement of the legislation was made conditional on the Administration's carrying out a comprehensive review and reporting back to the Legislative Council (LegCo) before proposing a commencement date. In May 2007, by way of panel paper CB(1)1643/06-07(07), the Administration reported to the then Panel on Planning, Lands and Works that –

- (a) the review had found that substantial amendments to the LTO were needed to ensure efficient operation of the new system;
- (b) an amendment bill would be prepared and submitted to LegCo before the title registration system was commenced; and
- (c) the opportunity would be taken in preparing the amendment bill to address concerns previously raised about the language and structure of the LTO.

3. The Administration, in the report to the Panel, outlined the extent of changes that had already been agreed and the range of issues that remained to be settled before the amendment bill could be completed. Members were advised that the amendment bill would be presented in the new term of LegCo after the 2008 elections.

4. The LR operates as a trading fund under the terms of the TFO. By resolution of LegCo in 1993 the Land Registry Trading Fund was established. The services to be provided by the LR were set out in an accompanying schedule. That schedule has not been revised since 1993 and needs to be amended to allow for the LR commencing and operating the title registration system.

PROGRESS WITH AMENDMENTS TO LTO

5. There remain four substantial matters to be finalised before the amendment bill is ready for consideration. These are –

- (a) the relationship between the LTO and other legislation;
- (b) arrangements for updating land boundaries;
- (c) modification to rectification and indemnity provisions; and
- (d) modification to the conversion mechanism.

Relationship with other legislation

6. During the post-enactment review of the LTO, a range of questions have been raised as to how the provisions of the Ordinance will operate in practice in relation to provisions in other legislation. Section 3 of the enacted LTO contains wordings that would allow other legislation to prevail over the LTO, without specifying what such legislation is. Section 28, which deals with overriding interests, has been found to create further uncertainty as it generally allows rights under other legislation to have effect as overriding interests, which do not have to be registered. This is irrespective of the fact that some other legislation requires registration in order for the matter to have effect.

7. There should be clarity in how the LTO is to work with other legislation and that the basic principle that the LTO should take priority over other legislation should be followed. With that in mind, an extensive examination of other legislation that makes provision for registration or contains references to the LR has been carried out. This has led to the following proposals –

- (a) where another legislation cannot stand together or run in parallel with the LTO, a decision will be made on whether that legislation or the LTO shall prevail. If the intention is not to undermine the intended effect of the other legislation, then provisions for a specific exception will be added in the LTO. In this way, it will be clear which other legislation or which particular provisions of other legislation prevail over the LTO. In all other cases the LTO will prevail and consequential amendments may be made to other legislation to resolve any inconsistencies;

- (b) section 28 of the LTO should be revised to include any rights relating to land under other legislation. Such rights do not however include charges over land arising under other legislation. If a particular charge arising under other legislation is intended to be an overriding interest, it will be specifically included in the list of overriding interests under section 28(1). Notices, orders and certificates relating to rights under other legislation will not be listed as overriding interests. Government departments will be required to register them under the LTO if the other legislation concerned requires their registration; and
- (c) to remove uncertainties over the handling of charges over land arising under other legislation, provisions for the registration, withdrawal and removal of such charges should be added to the LTO.

8. The Government is examining the implications of these changes and the LR will work to finalise the amendments to be made to the LTO and the consequential amendments to other legislation.

Updating Land Boundaries

9. Section 94 of the enacted LTO makes provision for the determination of land boundaries for land brought under the LTO. The Administration has been requested to consider introducing similar provisions in another ordinance to apply to land not yet brought under the LTO. In 2007 we reported that the Administration had decided to introduce comprehensive arrangements for dealing with updating of land boundaries in the Land Survey Ordinance (Cap. 473) (LSO). These will apply to all land, irrespective of whether it is land to which the Land Registration Ordinance (Cap. 128) (LRO) or the LTO applies. Section 94 of the LTO can then be repealed.

10. The Administration has subsequently presented detailed proposals for the new provisions to the Cadastral Consultative Committee. Draft drafting instructions for the amendments to the LSO have been prepared and it is intended to package these amendments as consequential amendments in the Land Titles (Amendment) Bill (LT(A)B).

Rectification and Indemnity Provisions

11. During the review two areas of concern have arisen regarding the enacted provisions on rectification (how the register is to be put right if found to be in error) and indemnity (how an innocent party who has relied on the register and suffers loss due to an error or fraud is to be compensated). The first is over ambiguity as to how particular provisions will work in practice. The second is

a more fundamental concern at the long term effect of the mandatory rectification rule adopted in the LTO enacted in 2004.

12. On the first point, the ambiguities requiring clarification include such matters as the time to be used for assessing the value of the loss on which indemnity is to be based; who is eligible to claim indemnity; how an indemnity is to be apportioned if more than one party has a claim and the total amount claimed exceeds the proposed cap; and how costs in proceedings are to be handled. Amendments to clarify these provisions so as to remove possible grounds for disputes that will slow down the resolution of claims or add to costs have been developed.

13. On the second point, the mandatory rectification rule is the provision that the Court must restore an innocent former owner to the register where a former owner has been removed due to a fraud. This rule was introduced in the LTO enacted in 2004 because of concern that the intended cap on the indemnity in fraud cases would place an innocent former owner in a worse position under the new system than at present (subject to the Limitation Ordinance (Cap. 347), the current common law approach always enables the former owner to get back the property in case of fraud). The innocent purchaser will be displaced and will only have a recourse of trying to recover their loss from the fraudster. With the cap on indemnity under the new system, if the Court were not to order rectification in favour of the former owner and the property were to have a value exceeding the cap limit, then a former owner may be left with an indemnity that is less than the value of the loss suffered.

14. The main question that has been raised over the mandatory rectification rule is the effect that it may have on the confidence of purchasers using the new system and on the ability of the new system to deliver the intended improvements in the efficiency and security of conveyancing. For a title registration system to work well, purchasers need confidence that they can rely on the land titles register. The mandatory rectification rule as adopted in the 2004 LTO may work to undermine that confidence. With the rule as currently enacted, a purchaser will not be sure that they are safe from a claim for recovery by a past owner. This may create incentive for purchasers to try to investigate the past history of transactions in the property, in effect to go back to the existing investigations of the chain of title. This would defeat the major objective of introducing title registration, which is to improve efficiency, reduce cost and provide certainty in property transactions.

15. In light of this assessment of the risk of the existing mandatory rectification rule undermining the potential benefits of the title registration, we have considered whether any amendments could be made to remove the risk. Modifications have been developed that would address the risk to confidence and deal with the practical issues that the current provision would raise.

16. **Annex A** illustrates the rectification and indemnity mechanism under the enacted LTO and sets out the suggested modifications to the mandatory rectification rule. It also sets out the proposed changes to remove the ambiguities outlined in paragraph 12 above. Initial sounding out on these proposals have been carried out with the Law Society of Hong Kong (Law Society)'s Working Party on Title Registration, the Hong Kong Bar Association (Bar Association), and the Real Estate Developers Association (REDA). A synopsis of their initial views is summarised in **Annex B**. We are considering their comments and seeking views from other interested parties, including the Consumer Council, Heung Yee Kuk (HYK), Estate Agents Authority (EAA) and Hong Kong Association of Banks (HKAB). We will consider the responses and determine whether any change to the mandatory rectification rule should be proposed in the LT(A)B before it is introduced.

The Conversion Mechanism

17. The conversion mechanism is the method that will be used to bring existing land and property to which the LRO applies over to the land titles register. The LTO enacted in 2004 lays down the following mechanism –

- (a) after commencement of the LTO, all existing land and property will continue to be dealt with under the LRO for a period of 12 years;
- (b) at the end of the 12 year period, all land and property to which the LRO applies will be brought under the LTO automatically except –
 - (i) where the subject of the register does not meet the definition of land that can be registered under the LTO;
 - (ii) where an instrument submitted for registration under the LRO has not completed registration before the date set for automatic conversion; or
 - (iii) where a caution against conversion has been registered prior to the conversion day and is still valid.

- (c) during the 12-year period, persons claiming to have an interest in a property that is not registrable or which is held under an instrument that has not been registered can either –
 - (i) register a caveat, giving notice of the claim, which may then be carried across to the land titles register upon conversion; or
 - (ii) register a caution against conversion, which stops conversion for a limited period during which the claimant can take action to establish his interest in the property through Court proceedings or agreement with the registered owner.

18. During the post-enactment review of the LTO, a range of issues concerning the conversion mechanism have been examined. They include such matters as the need for a mechanism to deal with properties where ownership is uncertain; how to manage the conversion most efficiently so as to minimise risks to public funds and costs to public users; and how to resolve questions over the priority of interests protected by caveats under the LRO.

19. After consideration of matters identified during the review, we are concerned that with the enacted conversion mechanism there is a mismatch between the costs of preparing for title registration, together with the liabilities that may be assumed upon conversion, and the revenue from title registration that will be available to meet those costs and defray any liabilities that may be realised. All the costs will be incurred before conversion, when there will be very little revenue from title registration, while liabilities may arise immediately upon conversion when there are no reserves to cover them. Any additional work that is done prior to conversion to try to reduce possible liabilities will add greatly to costs, exacerbating the gap in funding.

20. We have examined modifications to the conversion process that might address these issues and are consulting key stakeholders on the acceptability of any change.

21. At **Annex C** is a paper that sets out the conversion mechanism under the enacted LTO, the identified issues and suggestions for modification. These proposals have already been sounded out with the Law Society, Bar Association and REDA and their comments are contained in **Annex B**. The proposals have also been sent to other parties, including the Consumer Council, HYK, EAA and HKAB, for comments. The initial reaction from the Law Society Working Party, while appreciating the need for new provisions to tackle the issue so identified, has been to question the extent to which liabilities might arise on

conversion and to doubt the need for significant change to the enacted mechanism of conversion. The LR is engaging in further examination of the possible areas of risk with the Law Society Working Party to try to develop a shared assessment of the uncertainties and how far they can be reduced without time consuming and costly investigations.

22. The Administration will give careful consideration to the comments given by the Law Society and other parties before deciding whether and how to recommend modification to the conversion mechanism in the LT(A)B.

AMENDMENT TO SCHEDULE TO TFO

23. The LR was established as a Trading Fund under the TFO in 1993. A schedule approved by LegCo with the resolution establishing the Land Registry Trading Fund sets out the services to be provided by the department. This schedule needs to be amended if the LR is to implement the title registration system. The current schedule limits the Registry to “advising on and giving assistance in the introduction of an alternative system of land registration in Hong Kong”.

24. Other amendments are proposed to the schedule to allow the LR to introduce new value-added services for the benefit of the public. In particular, it is intended to authorise the department to collect stamp duty revenue on behalf of the Inland Revenue Department. This will allow the LR to provide a one-stop service for the stamping and registration of documents for the convenience of parties registering transactions.

25. Together with these main amendments, the opportunity will be taken to revise and update the schedule to ensure that the department is authorised to discharge its functions efficiently and to make full use of new technology to improve services.

26. Subject to Members’ views, the Administration intends to amend the schedule within the first half of 2009. Once approved, the LR will be able to proceed to introduce the one-stop service for stamping and registration.

WAY FORWARD

27. The Administration will shortly launch a three-month consultation exercise to solicit public views as well as continue discussions with major stakeholders on the conversion mechanism and rectification rules. In parallel, the LR will work to finalise amendments to clarify the relationship between the LTO and other legislation and complete other proposed amendments. We intend to circulate a further draft of the proposed amendment bill, together with draft rules, to the Law Society and other key stakeholders before introducing the

bill into LegCo. We expect that stakeholders will require some time to consider the draft. We do not anticipate being able to introduce the amendment bill before the end of 2009. We will make a further progress report to Members through this Panel in mid-2009.

**Development Bureau
December 2008**

**CONSULTATION ON
AMENDMENTS TO THE LAND TITLES ORDINANCE**

Rectification and Indemnity Provisions

PURPOSE

This paper seeks views on the proposed amendments to clarify how the arrangements for rectification and indemnity will work in practice and the proposed modification to the mandatory rectification rule.

BACKGROUND

2. A basic principle of title registration is that the title register provides an accurate statement of the title to a particular property that can be relied on by anyone dealing with that property. There is a risk that the land titles register can become inaccurate, whether due to deliberate fraud, a void instrument or mistake or omission.

3. To prevent injustice arising from an inaccuracy in the register, procedures are needed to allow for the register to be corrected. Using these procedures is called ‘rectification’.

4. There is also a risk that a person who has relied on the register may suffer loss due to an inaccuracy. If it is not possible to prevent or recompense for the loss by rectifying the register then financial compensation, called ‘indemnity’, may be paid. Where the inaccuracy is due to an error by a public officer in compiling or maintaining the register, the Land Registry (LR) will be responsible for paying indemnity and the amount to be paid will be the full extent of the loss suffered. In case an inaccuracy is due to fraud, indemnity for the loss suffered as a result of loss of ownership will be paid from a special fund built up from a levy on applications for registration. The Financial Secretary may set a limit (commonly called ‘the cap’) on the amount of indemnity to be paid in such cases.

5. During deliberation on the Land Titles Bill in 2003 it was argued that, because of the intended cap on indemnity in fraud cases, there was a risk that under the new system an owner whose name had been removed from the register by fraud would not be given full value compensation for his loss if the Court did not make a rectification order in his favour and the value of the property lost exceeded the amount of indemnity allowed by the cap. The Court might refuse to rectify if, after the fraud, a new purchaser, unaware of the fraud, had acquired and taken possession of the property in question.

6. Under the current common law system, in the circumstances set out in paragraph 5 an innocent purchaser would be required to give up the property without compensation – unless able to make a successful claim for recovery against the fraudster – while the former owner would recover the property.

7. The intended cap amount of HK\$30 million exceeds the value of 99% of all properties in Hong Kong. The likelihood of such cases as identified in paragraph 5 arising is low. Nonetheless, to address the objection to there being *any* risk of a former owner being left worse off (in money terms) under the new system of title registration than under the existing system, it was agreed to constrain the Court's powers of rectification in fraud cases. The constraint introduced was to require the Court to make a rectification order in favour of the former owner in any fraud case where it was found that the former owner was not a party to the fraud and did not by act or lack of proper care substantially contribute to the fraud. This requirement has been called the 'mandatory rectification rule'.

8. The Land Titles Ordinance (Cap. 585) (LTO) was passed in July 2004 on condition that a comprehensive review was carried out before the Administration sought to bring the new system into operation. The rectification and indemnity provisions enacted in 2004 have been examined as part of that review. The aim of this examination has been to assess whether they are sufficiently clear and consistent to work well in practice and whether the general effect will be conducive to the successful introduction of title registration into Hong Kong. After the examination it has been concluded that –

- (a) various provisions need to be clarified and some new provisions added to remove uncertainty and reduce the risk of disputes that may slow down the resolution of claims for indemnity and add to costs (see paragraphs 9 to 18 below for details); and
- (b) the mandatory rectification rule may have the unintended effect of reducing confidence in the title register and reducing the effectiveness of the new scheme in improving the efficiency with which conveyancing can be conducted. Opportunity should therefore be taken to reconsider whether the rule should be retained before the LTO is brought into operation. Paragraphs 19 to 28 below set out why the rule raises concern and describe modifications that would address these identified problems.

Points of Clarification

Handling of Land Registrar's costs

9. The review has found that there are two areas of uncertainty with respect to the handling of costs incurred by the Land Registrar (the Registrar) or awarded against the Registrar during rectification proceedings. The LTO gives no direction to the Court as to how the Registrar's own costs are to be dealt with, nor is it clear whether or not costs awarded against the Registrar in rectification proceedings are to be included within the indemnity payment that may be subject to the cap.

10. It is intended to add a provision to specify that the Registrar's costs in rectification proceedings are to be met by the indemnity fund unless otherwise ordered by the Court. This will remove uncertainty on the source of payment and prevent the possibility of the Registrar having to meet the costs himself simply because the Court had not made any order on the point in a particular case. It is considered appropriate to meet the Registrar's costs out of the indemnity fund since such costs would be incurred in the course of the Registrar exercising his duty to ensure that the fund is safeguarded from improper claims.

11. The LTO specifies that costs awarded against the Registrar are to be paid from the indemnity fund but is silent as to whether they come within the cap on the amount of money that may be paid as indemnity in a fraud case. It is intended to add clarification that the cap does not apply to costs awarded against the Registrar. This will be consistent with the intention that the indemnity should be based on the value of the interest that has been lost. Costs are not a part of this.

12. It is also intended to add a provision that the Registrar has the right to attend taxation hearings held by the Court to determine the amount of costs. His attendance at taxation hearings will allow the interests of the indemnity fund to be represented, providing a reasonable safeguard against the award of unreasonable costs.

Indemnity applications and costs

13. The review has noted that under section 85 of the LTO, the amount of indemnity that may be paid is limited to the 'value of the interest' held by the person suffering the loss. This is correct in fraud cases but would have the unintended effect of limiting the liability of Government for losses caused due to mistake or omission on the part of public officers. Section 85 will be amended to make clear that Government's liability arising from its own mistake or omission extends to all actual losses suffered.

14. The review has found some ambiguity in identification of the persons who may claim indemnity. It is intended to make clarification that in fraud cases, the persons who may be eligible to claim indemnity include both owners affected by rectification and other parties who suffer loss as a result of displacement of an owner by a rectification order or refusal to grant a rectification order. In mistake or omission cases any person who suffers actual loss may claim.

15. Section 84(1) uses the term “which affects ownership” to define cases in which indemnity may be paid in fraud cases. The review has noted some uncertainty over the meaning of this term. It is intended to replace it with “which results in the loss of ownership”. The proposed modification will make it clear that the indemnity fund will not be liable for claims in cases where there has not been any loss of ownership due to fraud.

16. The LTO states that the amount of indemnity to be paid is to be calculated on the basis of the value of the interest on the date on which the entry in the register that caused the loss was made. The review has found that this formula may not be applicable in various circumstances. In omission cases there is no entry that can be dated. The appropriate date for calculating loss should be the date of application for an entry that was subsequently omitted. In fraud cases where the person who suffers loss is a purchaser subsequent to the fraud, the appropriate date will be the date of the rectification order removing the purchaser from the register. It is intended to amend section 85 to allow for different dates for determining loss to be used in these circumstances.

17. The review has noted that the LTO does not specify how the indemnity is to be apportioned if there are multiple claimants arising from a fraud case and the total value of the claims exceeds the amount that may be paid due to the cap. To avoid disputes and the delay and cost of any litigation to resolve such questions should any case arise, it is intended to provide a rule for determining the apportionment in such circumstances. The rule to be proposed is that each claimant would be paid from the indemnity amount in proportion to the value of his loss. To give an illustration as to how this would work, let us assume a case in which the total claim amounted to \$40 million, exceeding the cap amount of \$30 million. Of the \$40 million claim, \$32 million is by the displaced owner and there are two further claims of \$4 million each by other parties who suffer loss because the owner is displaced. The displaced owner's share of the total claim would be 80%, while the other two parties' shares would be 10% each. The outcome under the proposed rule is that the displaced owner will be paid 80% of \$30 million, or \$24 million, while the other two parties each get 10% of \$30 million, i.e. \$3 million.

18. The LTO requires an interested party to make an application to the Registrar for the payment of indemnity. The review notes that no provision has been made for the Registrar's costs in processing the application are to be settled. It is intended to add clarification that the Registrar's costs of processing the applications will be met from the indemnity fund. It is also proposed to make clear that the applicant's costs for making such application to the Registrar are not payable unless awarded by the Court and such costs will also be met from the indemnity fund.

Mandatory Rectification

19. Paragraphs 5 to 7 above give the background as to why the mandatory rectification rule was introduced. The review has included a careful analysis of how the rule would be likely to work in practice. The relevant provisions of the enacted LTO are –

Section 82(1), which allows the Court to order rectification of the register by directing that an entry in the register be removed, altered or added if it is satisfied that the entry was obtained, made or omitted by or as a result of fraud.

Section 82(3), which requires the Court to make an order of rectification in favour of 'a former registered owner' (if innocent) if he lost his title by or as a result of fraud, irrespective of whoever is currently the registered owner. This is the 'mandatory rectification' provision.

Section 84(1), which states that a person suffering loss by reason of an entry in the register or omitted from the register that has been obtained, made or omitted as a result of fraud (as determined at the end of rectification proceedings under section 82) which has affected the ownership of registered land shall be indemnified by Government in respect of that loss.

Section 85(1)(a), which specifies the amount of the indemnity in fraud cases. Where the value of the interest in the registered land that has been lost on the date on which the entry was obtained, made or omitted is less than the cap, then the amount to be paid is the value of the interest lost. Where the value of the interest in the registered land that has been lost is higher than the designated cap then the cap amount is to be paid.

How would the enacted law work

20. To help show how the present LTO would work in cases where fraud happened after the land affected had been brought under the LTO, the following diagram represents a series of sales (denoted by →) of a property between a number of successive owners –

Owner:	A	→	B	→	C	→	D	→	E
Encumbrances:	A*		B*		C*		D*		E*

21. If there were a fraudulent transfer to C (C being a fraudster) in the diagram above, discovered when E had become the owner then –

- (a) B, the innocent former owner, would be restored to the register as owner, by operation of section 82(3);
- (b) B*, the encumbrances to which B was subject, may also be restored if still subsisting;
- (c) E, an innocent registered owner who acquired the property from D, would be removed from the register but would be eligible for indemnity. D, an innocent purchaser from C, is not involved in the rectification proceedings having sold his interest in the property;
- (d) encumbrances E* that are affected by the removal of E from the ownership register may arguably also give rise to entitlement to indemnity if loss is suffered as a result (the amendment proposed in paragraph 14 above will clarify that they may do so); and
- (e) if C had procured his registration as owner by fraud and had not sold the property on to D, C will be removed from the register and B restored. No indemnity to C arises.

22. The effect of sections 82(3), 84 and 85(1)(a) taken together is that –

- (a) the position of the innocent former owner under existing common law is preserved. He will recover the property; and
- (b) any registered owner risks loss of the property at any time during their ownership if a former owner is able to establish a claim that he had lost his title due to fraud and his right of action is not time barred. If the fraud occurs after the land is brought under the LTO and the current registered owner is an innocent party then he will be

eligible for indemnity. Although the indemnity may be subject to the cap this is still a better position for him than under common law. At present he will get nothing unless able to trace and undertake a successful action for recovery against the fraudster or other person responsible.

Why might the enacted law cause problems for the operation of the title registration system?

23. The following issues have been identified with respect to the current provisions on rectification –

- (a) no purchaser of registered property is protected by the title register against the effect of fraud prior to the transaction in which he is involved. This may undermine the security and ease of conveyancing that the LTO aims to achieve. A prudent purchaser will want to go behind the title register to investigate previous transactions in order to obtain greater assurance that he will not be at risk. This would amount to a reversion to the old system of investigation of title as under the current deeds registration system;
- (b) there may be cases in which, before a claim for rectification is made, the lot or lots affected have been resumed or surrendered to Government. Rectification to a former owner is a practical impossibility in such circumstances;
- (c) there may be cases in which, after the fraud, the property is divided up and sold on to several new owners or developed and undivided shares sold on to multiple new owners. Displacing and compensating multiple innocent parties in such cases is likely to cause greater disruption and incur greater cost to the indemnity fund than giving indemnity to the former owner; and
- (d) as drafted, the mandatory rectification rule applies to new land as well as to converted land, but there is no necessity for this as new land is never subject to the prior common law position and there is no question of a former owner of new land being put in a worse position than he previously enjoyed.

24. The review noted that the requirement for mandatory rectification to an innocent former owner was introduced as a committee stage amendment to LTO in 2004 in response to –

- (a) strong opinion that there should be certainty in the operation of the rectification provisions, rather than leaving wide discretion to the Court; and
- (b) recognition that, due to the effect of the cap, unless rectification was made in favour of the former owner a former owner might find himself worse off under the new system than under existing law.

25. The review considered that paragraph 24(b) above should not be a material consideration when dealing with new land. Furthermore, given the other identified difficulties that the mandatory rectification rule could cause, it was sensible to consider whether there was any better approach that could be developed for inclusion in the Land Titles (Amendment) Bill that is to be introduced before the LTO comes into effect. It was considered that any alternatives should try to keep as close as possible to the framework agreed in 2004. Mandatory rectification should be retained as far as possible and clear rules laid down for the Court.

The suggested modification to the rectification rule

26. Following from the general approach outlined above, the specific suggestions developed for modifying the rectification rule so as to address the identified problems are –

- (a) the mandatory rectification rule in section 82(3) is to be maintained but made subject to specific exceptions;
- (b) the exceptions proposed are where–
 - (i) the current registered owner who is in possession of the property is not the first person to have been registered as owner since the fraud. He is a bona fide purchaser for value or a person deriving title from such bona fide purchaser; or
 - (ii) there has been resumption or surrender of the property to Government since the fraud; or
 - (iii) the property has been divided up and sold or agreements for sale and purchase have been entered into for sale of the property to new bona fide owners resulting in multiple ownership of the property; and
- (c) an innocent former owner not restored to the title register due to the operation of any of the exceptions will be eligible for indemnity.

27. To illustrate the effects that these proposals would have, consider the same diagram previously used in paragraph 20 and the new consequences that would arise from the modified rules –

Owner: A → B → C → D → E
Encumbrances: A* B* C* D* E*

- (a) The innocent former owner, B, will recover from D (unless the property has been divided and D represents the more than one bona fide new owner of the property);
- (b) The former owner B will not recover from E, a second bona fide owner after the fraud who is in possession of the property;
- (c) In any event, B will not recover the property if it has been resumed or surrendered to Government;
- (d) If B does not recover the property he will be eligible for an indemnity subject to the cap; and
- (e) If B recovers from D, then as an innocent party D will be eligible for an indemnity that will be subject to the cap.

28. The proposal that a bona fide purchaser or his successor to title who is not the first bona fide party to deal with the property after a fraud should enjoy indefeasible title will bring what is called the doctrine of *deferred indefeasibility* into the LTO. This is a doctrine that has been applied in a number of jurisdictions that have title registration systems to achieve a balance among the need for the register to give security if it is to achieve the intended purpose of easing transactions, the reasonable claims of defrauded owners and the objective of keeping incentive for purchasers to exercise care. By giving security to the second bona fide owner registered after a fraud, owners are given security against historical matters which they have no practical means to investigate. But, a prospective owner does have to exercise care in the transaction by which they themselves become registered as owners since, if they have dealt with a fraudster, they are not given security against rectification in favour of the true owner affected by the fraud.

Change to Indemnity Provisions

29. If the modifications suggested in paragraph 26 were to be adopted, some change would also be needed with respect to the handling of cases where land had been converted to the title register and a fraud that had been committed

before conversion was subsequently discovered. The LTO currently contains a provision (section 84(4)(c)) which bars the payment of indemnity in any case where the fraud took place before the date of conversion. The intention is to protect the indemnity fund from having to compensate for conditions that existed before conversion of which Government could have had no knowledge and could not control. If the concept of deferred indefeasibility is brought into the LTO then the possibility will be created that a former owner may be barred both from recovering the property and, if the fraud that removed him from the register occurred before conversion, he would also be barred from any indemnity. Conversely, if the mandatory rectification rule were to be left in place, any post conversion purchaser could find themselves facing loss of the property without any indemnity due to a the pre-conversion fraud, even though they would have paid the levy for the indemnity fund upon application for registration as owner. In either circumstance it would not appear just to bar the payment of indemnity.

VIEWS SOUGHT

30. The Administration is inviting views on –

- (a) whether all of the modifications to the mandatory rectification rule proposed in paragraph 26 should be adopted; or
- (b) whether only the modifications to address the issues set out in paragraph 23(b) (where land has been surrendered or resumed subsequent to a fraud) and 23(d) (deferred indefeasibility to be the rule for new land) should be adopted; and
- (c) the proposed clarifications to various provisions set out in paragraphs 9 to 18.

**Development Bureau
December 2008**

Annex B

Initial Views from the Law Society of Hong Kong, the Bar Association and the Real Estate Developers Association

(Note: for further details about the Administration's proposals, please refer to the papers at Annexes A and C of the Panel paper.)

<u>Comments</u>	<u>Response by Administration</u>
1. Conversion	
(a) Working Party on the Land Titles Ordinance (WP) of The Law Society of Hong Kong	
<p>(i) <u>Doubt on the effect of proposed conversion mechanism to solve the problem</u></p> <p>WP considered that the new proposed conversion mechanism would not assist to identify the problem registers but would just prolong resolution of the problem for 12 more years, allowing for more potential transactions to come onto the problem registers before these registers would be dealt with on an application for upgrading.</p>	<p>Under the proposed conversion mechanism, absolute title would not be vested in respect of problem cases on conversion. The position of the parties concerned would not be worse off than their existing position under the Land Registration Ordinance (Cap. 128) (LRO).</p>
<p>(ii) <u>Indefinite dual system</u></p> <p>WP found it difficult to accept the idea of provisional title when such title could be condemned in perpetuity and there would be no mechanism to ensure all provisional titles would mature into absolute ones.</p>	<p>Whether a property could be upgraded depended on whether the 'owner' had good holding title. It would be fundamentally wrong in principle to convert a bad or doubtful title to absolute title.</p>
<p>(iii) <u>Government should deal with problematic registers forthwith to prepare for automatic conversion 12 years later</u></p> <p>WP considered that the Government should be more proactive and try to identify and deal with the problematic registers forthwith to prepare for automatic conversion 12 years later.</p>	<p>There were currently around 2.8 million land registers kept in the Land Registry (LR). Given the volume of these registers and continuous activities in the property market, it would be impractical to go through all the registers within 12 years to identify all problem registers.</p>

<u>Comments</u>	<u>Response by Administration</u>
<p>(iv) <u>Lack of concrete examples of problem registers</u></p> <p>WP pointed out that the Administration had not given any concrete examples of the problematic registers and had not briefed it fully on what the risks were relating to the problem registers, or indeed whether or not there were such risks.</p>	<p>The Administration is arranging to meet the WP with examples of the problem registers by way of mock transactions.</p>
<p>(v) <u>Doubt on Government's liability for the problematic registers</u></p> <p>WP considered that the Government's liability for the problem registers would probably be very small. It would be hard to imagine a significant portion of the LRO registers involved conflicting claims but the interested parties were happy to ignore the conflicting claims.</p>	<p>The Administration could not safely assume that the Government's liability for the problem registers is small. We consider it necessary to screen all the 2.8 million land registers before upgrading.</p>
<p>(vi) <u>Reliance on the integrity of registration system and objection to late stage substantial change</u></p> <p>WP pointed out that the Government indicated on day one that it had confidence on the integrity of the registration system under the LRO; and the drafting of the LTO had proceeded on that basis. WP found it difficult to understand why the Government, having told the profession, the LegCo and the community that the registration system under the LRO could be relied on for daylight conversion, decided to go back and say at this late stage that there should be very substantial change on the conversion mechanism just because of the existence of an insignificant number of problem registers.</p>	<p>One of the purposes of the post-enactment review of the Land Titles Ordinance (Cap. 585) (LTO) was to give full consideration to the impact of the significant changes made to the Land Titles Bill at the committee stage. As part of the review, the LR has been tasked to review all risks involved in implementing automatic conversion.</p> <p>The Administration fully understood WP's concern at the suggestion of introducing a significant change to the conversion mechanism. But, given the potential liabilities to public fund, measures to manage the risk are necessary.</p>

<u>Comments</u>	<u>Response by Administration</u>
(b) Hong Kong Bar Association (Bar Association)	
<p>(i) <u>Agree to the benefits of the proposed conversion mechanism</u></p> <p>The Bar Association agreed that there would be some benefits in the proposed conversion of existing land to an interim status of ‘converted land’ after three years and upgrading to full title after a further period of 12 years.</p>	<p>The Administration noted this point.</p>
<p>(ii) <u>Caveat</u></p> <p>The Bar Association noted that under the enacted LTO, protection was given to unwritten equities by registration of caveats throughout the 12 years before automatic conversion. However, under the proposed conversion mechanism, there was no provision for registration of unwritten equities prior to conversion. The Bar Association was in favour of retaining the protection afforded to the unwritten equities even under the proposed conversion mechanism.</p>	<p>Under the proposed conversion mechanism, the holder of a pre-conversion unwritten equity might at any time after conversion but before upgrading of title record a warning note to protect his interest. The Administration did not wish to complicate the system by implementing a caveat system under the LRO for registering such interests, which would only be used for about three years. During this three-year period the holder of an unwritten equity might at any time take legal action and register a lis pendens under the LRO to protect his interest. His right remained unaffected under the proposed conversion mechanism.</p>
(c) The Real Estate Developers Association of Hong Kong (REDA)	
<p><u>No principle objection</u></p> <p>REDA replied that they had no in principle objection to the proposed alternative conversion mechanism.</p>	<p>The Administration noted the comment.</p>
2. Rectification and Indemnity Provisions	
(a) WP	
<p>(i) <u>Agree in Principle</u></p> <p>WP agreed with the proposals in principle regarding proposed changes to provisions on fraud affecting new land.</p>	<p>The Administration noted the comment.</p>

<u>Comments</u>	<u>Response by Administration</u>
<p>The proposals were (a) the mandatory rectification rule in section 82(3) would be maintained, subject to specific exceptions; and (b) an innocent former owner not restored to the title register due to the operation of any of the exceptions would be eligible for indemnity.</p>	
<p>(ii) <u>Inconsistency between converted title property and registered title property</u> Regarding the proposal that a property with converted title would be subject to subsisting interests and that, prior to upgrading, the mandatory rectification rule and the rectification exceptions would not apply to fraud committed before conversion, WP was concerned that there would be inconsistencies if common law principles were to apply before upgrading.</p>	<p>Prior to upgrading of title, interests under LRO and common law remain undisturbed. Existing common law principles would continue to apply to converted properties as if they had not been converted. For pre-conversion fraud, LTO rectification provisions and proposed exceptions would not apply. Common law principles would continue to apply.</p>
<p>(iii) <u>Limiting the right of indemnity to ‘loss of ownership’</u> Regarding who would be entitled to claim indemnity, WP noted that it would be limited to cases where there had been a ‘loss of ownership’. The WP believed the proposal should refer to ‘title’ rather than ‘ownership’ and had concern as there would be occasions that someone having an interest in registered land could suffer loss although the title of the owner had not been lost.</p>	<p>It had always been the Administration’s intention to compensate a person who suffered loss by or as a result of fraud which affected ownership of registered land. ‘Title’ was not defined whilst ‘owner’ was a well-defined word under LTO. Ownership is an easily understandable concept in LTO context.</p>
<p>(iv) <u>Apportionment amongst multiple claimants</u> WP believed the proposal on the apportionment of the indemnity amount should be subject to any contrary intention expressed by parties, in particular chargor and chargee.</p>	<p>The proposed apportionment did not affect distribution of indemnity between owner and his chargee. It applied to apportionment of indemnity between an owner and other claimants such as tenants.</p>

<u>Comments</u>	<u>Response by Administration</u>
<p>(v) <u>Finance for starting off indemnity fund</u></p> <p>WP noted the Government's concern that indemnity fund would be accepting liabilities without income to offset them. WP recalled that the Government agreed earlier to provide seed money to start off the indemnity fund.</p>	<p>The Government agreed to provide a loan as seed money to start off the indemnity fund. The loan had to be repaid to the Government. The indemnity fund would be self-financing with income generated from the levy. The Government could not accept unquantifiable and unlimited liabilities without income to offset them.</p>
<p>(vi) <u>Application to daylight conversion system</u></p> <p>WP could not see why the proposed exceptions to mandatory rectification rule should not equally apply to the daylight conversion system.</p>	<p>The proposed exceptions could not apply to daylight conversion as no indemnity would be payable for pre-conversion fraud discovered after conversion under daylight system. If proposed exceptions were to apply, a former owner who lost property due to pre-conversion fraud might not be able to recover his property and no indemnity would be payable. His position would be worse than his existing position under the common law.</p>
<p>(b) Bar Association</p>	
<p>(i) <u>Cap on indemnity</u></p> <p>The Bar Association restated its strong objection to the upper limit on indemnity payable to an innocent owner whose interest was extinguished by reason of the rectification provisions under the LTO.</p>	<p>The concern with upper limit on indemnity in fraud cases was noted. In considering any changes to the rectification and indemnity provisions, the Administration appreciated that these concerns would need to be taken fully into account before a decision was made on how to proceed.</p>
<p>(ii) <u>Arbitrary exceptions</u></p> <p>The proposed exceptions to mandatory rectification seemed rather arbitrary. The different treatment of the first registered owner after the fraud and subsequent registered owners (albeit both innocent) may be perceived as unfair or arbitrary.</p>	<p>Some jurisdictions adopt 'immediate indefeasibility' whilst others adopt 'deferred indefeasibility'. It was proposed to adopt 'deferred indefeasibility' in Hong Kong because the first registered owner when acquiring a property from a fraudster would</p>

<u>Comments</u>	<u>Response by Administration</u>
	have opportunity to conduct the necessary enquiries to avoid the fraud. The second registered owner had no such opportunity. This principle represented a fair balance of interests among innocent parties in case of fraud.
<p>(iii) <u>Exception relating to multiple purchasers</u></p> <p>As a matter of principle, it would be difficult to justify the exception where property had been divided up and sold to multiple purchasers. It would seem unfair that a defrauded former owner whose property was sold to one purchaser would have his title restored whereas a defrauded former owner whose property had been divided and sold to two purchasers would not be restored to ownership of the property.</p>	The exception would only apply in very limited circumstances. It would only apply when a property acquired by fraud was redeveloped or divided up and sold <u>directly</u> by fraudster to two or more purchasers. The proposal represented a fair balance of interests among innocent parties in case of fraud.
<p>(iv) <u>Inconsistency between converted title property and registered title property</u></p> <p>For pre-conversion fraud, distinction between converted title properties and registered title properties could lead to anomalies. In case of pre-conversion fraud, owner of converted title property would be displaced by innocent former owner and would not be entitled to indemnity. However, if the claim was made/established after upgrading, the owner would be entitled to indemnity. The right of registered owner to claim indemnity would depend entirely on the date that the claim of the innocent former owner was made/established.</p>	For pre-conversion frauds, common law rules would continue to apply prior to upgrading. Purchaser would take property subject to subsisting interests. An innocent former owner would recover property in case of void transaction while an innocent purchaser would lose the property without indemnity. After upgrading of title, full benefit of title registration system would be afforded to purchaser. The Administration was prepared to extend the protection of indemnity to pre-conversion fraud after upgrading as the LR would have had the opportunity to check title prior to upgrading.

<u>Comments</u>	<u>Response by Administration</u>
<p>(v) <u>Limiting the right of indemnity to ‘loss of ownership’</u></p> <p>There would be no reason for limiting the right of indemnity to ‘loss of ownership’ and that loss of other kinds of interests especially encumbrances ought similarly to give rise to a right of indemnity.</p>	<p>It had always been the policy intent to limit the right of indemnity to cases where there had been a ‘loss of ownership’. Where there were parties who suffered loss in consequence of displacement of an owner, those parties might also be eligible to claim indemnity for their loss.</p>
(c) REDA	
<p>(i) <u>Cap on indemnity</u></p> <p>REDA restated the objection to the cap on indemnity. REDA accepted the cap only on the basis that innocent original owner would be entitled to have title restored under mandatory rectification rule. The proposed exceptions would substantially abrogate the mandatory aspect of the rule.</p>	<p>With the mandatory rectification rule, no purchaser would be protected by the title register against the effect of fraud committed prior to the transaction in which he was involved and he risked losing his property at any time during his ownership. The security and ease of conveyancing that LTO aimed to achieve would be severely undermined.</p>
<p>(ii) <u>Exception relating to deferred indefeasibility</u></p> <p>Exception (1) (registered owner in possession not the first person registered as owner since fraud) was very widely drawn. This amounted to a fundamental departure from the spirit of the mandatory rectification rule and the philosophy behind it. No justification was provided as to why the rights of innocent original owner should be fundamentally altered simply because the property had changed hands.</p>	<p>The integrity and conclusiveness of the title register is the cornerstone of a title registration system. Some jurisdictions adopt ‘immediate indefeasibility’ while other adopt ‘deferred indefeasibility’. The concept of ‘deferred indefeasibility’ was considered to be more appropriate for adoption in Hong Kong.</p>
<p>(iii) <u>Exception relating to resumption or surrender</u></p> <p>Regarding exception (2) (resumption or surrender property to Government), REDA had difficulties in understanding</p>	<p>Where a property was resumed or surrendered to Government, the resumption or surrender would be for a specific purpose and the property would no longer be held under a lease. The property could</p>

<u>Comments</u>	<u>Response by Administration</u>
<p>why an innocent original owner should stand to lose his property simply because the property had been resumed or surrendered to Government. An application of exception (2) might result in the loss to the innocent original owner of his property or had the effect of appropriation of property without compensation or adequate compensation. The Administration needed to address whether exception (2) would be contrary to Articles 6 and 105 of the Basic Law.</p>	<p>not simply be handed back to a former innocent owner. It would be impractical to rectify the title register in such circumstances. REDA's concern about compliance with the Basic Law was noted and the LR would maintain close liaison with the Department of Justice.</p>
<p>(iv) <u>Exception relating to multiple purchasers</u> The protection of the innocent purchasers should not be made at the expense of the innocent original owner whose remedy should not be limited by the cap. If exception (3) (property sold into multiple ownership) were to apply, certain criteria had to be set and satisfied. It would be difficult to see why the exception should apply simply because the land was developed into two town houses one of which had been sold.</p>	<p>The concern regarding the cap on indemnity was noted. The determination of 'sufficient number of bona fide purchasers' was arbitrary. The only effective rule was that once the land was divided up and two or more innocent purchasers were involved, it would be just and reasonable for the exception to apply.</p>
<p>(v) <u>Costs payable by Land Registrar (Registrar)</u> Whilst REDA accepted that as a general rule, the Registrar's costs should be paid out of the indemnity fund, there might be circumstances where due to the conduct of the Registrar or some other person, the costs should be borne either by the Registrar or by some other person. The provision should be qualified such that it would be so 'unless otherwise ordered by the court'.</p>	<p>Registrar's costs in handling application for indemnity did not involve court proceedings unless the applicant rejected the indemnity offered. It should be made clear that the Registrar's costs of processing application be charged to the indemnity fund. The Administration agreed that the Registrar's costs should be paid out of the indemnity fund unless otherwise ordered by the court.</p>

**CONSULTATION ON
AMENDMENTS TO LAND TITLES ORDINANCE**

**Conversion of Existing Land and Property
to Land Title Registration System**

PURPOSE

This paper sets out the findings of the post enactment review of the Land Titles Ordinance (Cap. 585) (LTO) with respect to the conversion of existing land to the title registration system and seeks views on possible modifications.

BACKGROUND

2. It is intended that the LTO will apply to all leased land in Hong Kong. For new land that is granted after the commencement of the LTO, the position is simple. It will be registered from the start under the LTO. No account needs to be taken of pre-existing matters. For land now dealt with under the Land Registration Ordinance (Cap. 128) (LRO), provisions are needed to govern how that land will be brought under the LTO and how rights and interests that may exist under the common law are to be handled during the conversion from the LRO registers to the land titles register under the LTO.

3. The conversion mechanism set out in the LTO enacted in 2004 contains the following features –

- (a) **The interim period:** After commencement of the LTO but before any conversion takes place there will be a period of time during which existing land will continue to be dealt with under the LRO. Conveyancing for this type of land will continue to have reference to the Conveyancing and Property Ordinance (Cap. 219) and conveyancing documents will continue to be registered under the LRO. The interim period was set as 12 years after the commencement of the LTO. There is provision to reduce or extend this period, subject to the approval of the Legislative Council;
- (b) **Caveats and Cautions against Conversion:** The LRO will be amended to introduce two new arrangements during the interim period to help prepare for the conversion –
 - (i) Registration of a notice of a claim to an interest in property that is created by the operation of the existing common law.

An example of this would be a claim by a spouse who has contributed to mortgage payments. Although these interests are recognised under the common law, there is no instrument that can be registered and the LRO does not at present allow for registration of any notice of a claim. Under the LTO, if no notice of an interest or claim to an interest is given on the land titles register, then the interest or claim is not secured against the property. The new provision will allow an instrument called a caveat to be registered under the LRO to give notice of such claims. Registration of a caveat would not prevent conversion of the property or validate the claim. The caveat will be deemed as a caution on land titles register after conversion, so preserving notice of the claim for anyone intending to deal with the property.

- (ii) Registration of a caution against conversion. This would serve to prevent conversion taking place while an action to determine an interest was underway. A caution against conversion will have a limited validity period, lapsing after one year unless legal proceedings have commenced or the Court allows an extension. As soon as a caution against conversion lapses, or the Court makes a determination on the interest claimed, the affected register will be converted to the land titles register;
- (c) **Automatic Conversion:** At the end of the interim period, every property for which a register has been kept under the LRO would be transferred automatically to the LTO register except –
 - (i) property against which a caution against conversion that had not lapsed was registered;
 - (ii) property for which instruments had been submitted for registration before the conversion date but had not yet completed registration or been withdrawn; and
 - (iii) the subject matters of registers that had been kept under the LRO but which do not meet the definition of land that may be registered under the LTO;
- (d) Before a first transaction for valuable consideration under the LTO of a converted property, a registered owner remains subject to any unwritten interests or interests under unregistered instruments

enforceable against the property at the time of conversion. A claimant to such an interest who had not acted before conversion to register a caveat under the LRO may still, after conversion, apply to enter a caution on the land titles register under the LTO to protect his interest. But once the property is sold to a purchaser for value under the LTO, any interests not protected by a caution on the land titles register will not bind the purchaser. If no notice had been given to the purchaser through a caution, the claimant to any such interest would only be able to pursue his claim through action against the vendor.

4. These features were intended to address the following concerns and expectations –

- (a) **Notice and opportunity to act:** there should be sufficient notice to the public about the impending change and sufficient opportunity for interested parties to act to protect interests not at present registered under the LRO. The 12-year interim period gives substantial time within which to ensure that all reasonable measures to inform the public of the change can be given. The amendments to the LRO give interested parties simple and effective means to prevent loss of an interest that might otherwise happen if an owner were to sell a property immediately after conversion before a claimant had opportunity to enter a caution on the land titles register. The caveat provides a simple means to give notice of a claim before conversion. The caution against conversion allows interested parties to prevent conversion while a claim is determined so that the land titles register will give a proper reflection of the state of title;
- (b) **Certainty over conversion:** there should not be an indefinite period of parallel operation of the LRO and LTO with an uncertain timetable for conversion. The automatic conversion of almost all existing registers at the end of the specified interim period would leave the LRO with only vestigial effect; and
- (c) **Avoiding new liabilities:** the process of conversion should not impose additional liabilities on conveyancing solicitors beyond those currently assumed by them towards their clients in conveyancing transactions. The automatic conversion process would not create any new liabilities for solicitors.

QUESTIONS RAISED OVER ENACTED CONVERSION MECHANISM

5. During the post-enactment review of the LTO, the following issues have been found to present practical difficulties for the conversion exercise if the enacted legislation remains as it is –

- (a) **Indeterminate ownership:** Unless an LRO register falls within one of the specific categories for exclusion set out in paragraph 3(c) above, the Land Registrar (the Registrar) is obliged to keep a corresponding record in the land titles register, which involves stating who the registered owner is. Cases have been found where it is not clear who the true owner is. Either multiple registers exist that appear to refer to the same property or there are single registers that appear to contain more than one chain of title to the same property. Under the LRO, the Registrar is not empowered and ought not to be making a judgement as to who the owner in such cases should be. Nevertheless, under the land title registration regime, as the enacted LTO stands the Registrar would be compelled to do so since there is no power either to withhold conversion of the property pending a Court finding or to give a special status to the converted titles that would not prejudice a subsequent determination of ownership by the Court. The number of such cases that have been identified so far is not large (less than 500 to date) but without a disproportionately costly and time consuming investigation of deeds behind each individual register it will remain uncertain whether all cases of indeterminate ownership have been found.
- (b) **Unknown liabilities:** The Land Registry (LR) is liable for any errors in the land titles register that are due to the mistake or omission of public officers. Since there is no requirement to register instruments affecting land under the LRO, nor any requirement for the LR to investigate the validity of deeds before they are registered, there is a risk that upon conversion the land titles register will not be accurate due to the mistakes or omissions of other parties. There is no practical means of assessing the extent of such inaccuracies. As the public would rely on the land titles register to enter into transactions, the LR may owe a duty of care and be held liable to any party who suffers loss due to inaccuracy in the land titles register, whether or not the mistake or omission was that of a public officer or a private party.
- (c) **Impracticality of pre-conversion screening:** During the interim period the LR will prepare the existing LRO registers for

conversion. This process is not an in-depth investigation of title for each of the 2.8 million registers, only a screening exercise to match the requirements of the LTO and ensure that the converted registers are as clear and straightforward to use as possible. Adding detailed title investigation to this process to try to address the issues noted in subparagraphs (a) and (b) above would be disproportionately costly to carry out within the time available. Investigation could only be based on information held by the LR, so finding could not be definite. The process would be seriously complicated by the registration of new documents during the interim period. Based on past records, around 8 million new documents can be expected to be registered over the 12-year period. The reliability of any investigation of title already carried out on a register affected by subsequent entries before conversion would be questionable;

- (d) **Mismatch between costs, possible liabilities and financing:** During the interim period income from transactions under the LTO will be very low. In the initial years it will not cover the cost of operating the system, nor over the whole period will it be able to contribute to the costs of preparation work or to providing a reserve to cover possible liabilities that may arise on conversion. Upon conversion the LR will have to be ready to address any liability for errors and omissions for claims that may arise under the LTO. The LTO revenue will increase after conversion as all transactions will be registered under the LTO but there will be a period of several years where the financial stability of the Trading Fund may be at risk due to the uncertainty over liabilities. Setting an equitable levy rate to finance the indemnity fund for fraud cases is also made difficult by the very low LTO transaction volumes during the interim period;
- (e) **Conversion of Caveats:** Before a first transaction for value under the LTO of a registered property, the property remains subject to any unregistered interests that are enforceable at the time of conversion. The review has found potential for disputes and litigation over the priority among these unregistered interests, interests under a caveat registered prior to conversion and interests under a caution registered after conversion. Complex transitional provisions will have to be added to the LTO to establish how the priority is to be determined among such interests.

6. Apart from the practical issues identified during the review, set out above, external commentators have continued to raise questions about the conversion mechanism. Property market analysts question the effect that the long period of dual running may have on the behaviour of the property market by giving advantage to the primary market – for which transactions will be under the new system – over the secondary market until conversion takes place. The Law Society remains concerned about having to operate under two systems for so long and would like to see earlier conversion. On the other hand, the Heung Yee Kuk continues to be doubtful about automatic compulsory conversion and would prefer a voluntary approach, at least in respect of land covered by Part II of the New Territories Ordinance (Cap. 97).

7. There is no ideal solution that would address all of the practical issues or preferences of different parties. However, after considering the practical issues, in particular the financial position and uncertainty over liabilities, the LR has assessed whether there are modifications to the conversion mechanism that would –

- (a) allow for cost effective reduction of risk of liabilities to public funds arising from the conversion; while
- (b) avoiding the imposition of new liabilities on solicitors.

SUGGESTIONS FOR MODIFICATION

8. The approach that the LR has identified that can give a high assurance of reducing liabilities, without imposing excessive cost on the public who pay for the system through registration fees, is to revert to a gradual approach in which conversion would take place on a case by case basis upon the first transaction in each property after commencement of the LTO. Since this gradual approach was rejected in 2003, the LR has suggested an alternative scheme for consideration instead.

9. The features of the alternative scheme would be –

- (a) **LTO on commencement applies only to new land:** this is the same as under the LTO enacted in 2004. The reason is to get the system for title registration into operation as quickly as possible and tested before conversion begins;
- (b) **Conversion of LRO land accelerated:** automatic conversion from LRO registers to the land titles register would take place after about three years, rather than at the end of 12 years. The timing for conversion would be determined by how quickly the information

technology system and process for managing the conversion of the registers could be put in place;

- (c) **New status for converted land:** transactions in converted land would remain subject to any subsisting interests and title would have to be deduced as required under the Conveyancing and Property Ordinance until title is upgraded;
- (d) **Upgrading of title:** at a specified time after conversion an application would be allowed for approval to upgrade the title. The approval would be given by the LR. No certificate of good title would be required from a solicitor in private practice. The application process would allow for the Registrar to undertake such screening as was appropriate for the title in question. The specified time suggested after which applications for upgrading would be allowed is 12 years after the conversion date. This would reduce the risk of there being any pre-conversion issues remaining to be dealt with;
- (e) **No amendment to LRO:** the early conversion of all properties and the new status of converted land would remove the need for caveats or cautions against conversion. Converted land would remain subject to subsisting interests until upgrading. There would be no possibility of upgrading happening immediately after conversion, so a party having a claim under an unwritten equity would not be faced with an immediate risk of losing their interest if the property were sold directly after conversion. They would have time to put a warning note on the land title register to give notice of their claim before upgrading took place.

10. The benefits of an alternative scheme on these lines would be –

- (a) **Limited initial liability:** upon conversion, the LR would not immediately have the risk of uncertain liabilities, since all converted land would still be subject to pre-conversion interests. This removes the difficulty of determining what level of reserve is needed to guard against such risks and the cost of building up that reserve prior to conversion;
- (b) **Controlled cost of screening:** screening of titles need only be carried out upon applications for upgrading. Applications will be limited to registers where there are transactions. The extent of

examination required can be matched to the circumstances of each particular application;

- (c) **More balance between revenue and risk:** upon conversion the LR will start to receive substantial revenue for registration under the LTO. This will be before the full extent of any liabilities that may arise after upgrading is encountered. This will enable the LR to plan for the upgrading on the most efficient basis in terms of costs to the public, balancing the cost of any title investigation against the level of risk that might be incurred;
- (d) **Avoiding new provisions to exclude indeterminate titles from conversion:** with the upgrading process, the only requirement will be for a power for the Registrar to reject an application for upgrading if there is still uncertainty over the title at the time of application. Under the mechanism stipulated under the enacted LTO, exclusion from conversion will have to be provided for under the LRO, together with all necessary mechanisms for review, appeal and settlement of any claims that may arise;
- (e) **Avoiding new transitional provisions:** As there will be no amendments to the LRO to introduce caveats, no complex transitional provisions to determine the priority of unwritten interests (whether registered under caveat or caution or not) after conversion will be required, reducing complexity of the legislation;
- (f) **Early benefit from indemnity provisions:** Although holders of converted land will not enjoy the full benefit of the title registration system until title is upgraded, any purchaser of converted land before upgrading will be safeguarded under the LTO in respect of transactions registered under the LTO.

11. Against the benefits set out in paragraph 10, it should be noted that the modified approach to conversion set out in paragraph 9 would have the following disadvantages when compared with the conversion scheme under the enacted LTO described in paragraph 3 –

- (a) **Indefinite timetable for upgrading:** there would be no certainty as to when upgrading of titles for all properties would be completed;
- (b) **Dual system prior to upgrading:** transactions in converted land will be subject to different rules than those for new land. Solicitors will need to deal with these differences until such time as

a property is upgraded. The difference in treatment may affect perceptions of converted land prior to upgrading and affect the market for such properties;

- (c) **Separate fee for applications to upgrade title:** owners will have to pay separately for applications for upgrading. Under the conversion mechanism in the enacted LTO, all costs of preparing for conversion and dealing with any liabilities that are incurred by conversion will have to be met by increasing all registration fees.

VIEWS SOUGHT

12. We would like to invite views on the following –

- (a) Are the issues identified in paragraph 5 matters that should be resolved before commencement of the LTO?
- (b) Would the proposed modified conversion mechanism set out in paragraph 9 be preferable to the mechanism under the enacted LTO described in paragraph 3?
- (c) Would it be preferable to have the title registration commence for new land only while further deliberation on how best to settle the conversion mechanism is carried out?

Development Bureau
December 2008