

**For discussion
on 16 June 2009**

**LEGISLATIVE COUNCIL
PANEL ON DEVELOPMENT
AND
PANEL ON ADMINISTRATION OF JUSTICE AND LEGAL SERVICES**

**JOINT SUBCOMMITTEE ON
AMENDMENTS TO LAND TITLES ORDINANCE**

**Evaluation of Options for
Conversion and Rectification Arrangements
under Land Titles Ordinance**

PURPOSE

This paper assesses the options available for dealing with amendments to the conversion and rectification arrangements in the Land Titles Ordinance (Cap. 585) (LTO) in light of the responses to the public consultation exercise conducted from January to March 2009, and the risks and problems identified by the Administration in implementing the 2004 enacted LTO pursuant to the post-enactment review.

BACKGROUND

2. At the meeting of the Joint Subcommittee on 21 April 2009, the Administration undertook to provide an assessment of possible modifications to the conversion mechanism stipulated in the LTO enacted in 2004 (2004 conversion mechanism) or to the alternative proposal suggested in the recent consultation exercise (see Paper CB(1)396/08-09(06) of the Panel on Development of the Legislative Council (LegCo) dated 19 December 2008) (2008 alternative proposal); and an analysis of how well the modifications could address the issues identified with the 2004 conversion mechanism. Implications for the rectification provision would also be considered and an assessment provided on options for addressing this matter.

CONVERSION MECHANISM

3. Under the 2004 conversion mechanism, all eligible¹ existing land for which registers have been kept under the Land Registration Ordinance (Cap. 128) (LRO) must be converted automatically to land registered under the LTO 12 years after the LTO commencement date. The major issues that have been identified with this “Daylight Conversion” mechanism include –

- (a) **Problematic registers:** There are cases where titles are not clear, such as cases where there are two or more registers with different owners for the same lot or more than one chain of ownership under the same register. Under the 2004 enacted LTO, the existing registers will be deemed to form part of the title register and title will be vested in the person named in the title register as owner. Under the enacted LTO, there is no mechanism to withhold such cases from conversion or any provision to deal with the consequences.
- (b) **Conversion liabilities:** Under the 2004 conversion mechanism, the existing registers are deemed to form part of the title register. But we could not rule out that some registers might not be accurate, and the Government may be liable for any loss caused to parties where the title register is not correct. The Government’s exposure to such liabilities will arise from the conversion day.

4. From the responses to the public consultation it is clear that, with respect to the *conversion mechanism* –

- (a) there is support for some modifications to the 2004 conversion mechanism to address known cases of indeterminate ownership and provide some means to protect the Land Registry Trading Fund (LRTF) from the conversion liabilities as described in paragraph 3 above, but these should be made within the enacted framework of the “Daylight Conversion” mechanism (i.e. automatic conversion 12 years after commencement of the LTO); and

¹ “Eligible” land is land that meets the definition of land for which title can be registered under the LTO and against which no caution against conversion subsists and no outstanding deed remains pending registration.

- (b) there is very strong opposition to the 2008 alternative proposal that involves scrutiny of individual registers at the owners' expense before upgrading to full title and an uncertain timetable for completion of the conversion exercise.

5. The options that we have assessed and compared against each other for the conversion mechanism, therefore, are –

- (a) making limited additional provisions to the 2004 conversion mechanism and LRTF arrangements; and
- (b) modification of the 2008 alternative proposal to replace scrutiny of individual registers before upgrading with an automatic upgrading mechanism.

Modification of 2004 Conversion Mechanism

6. To deal with known cases of indeterminate ownership (paragraph 3(a) above), we may empower the Land Registrar (the Registrar) to exclude certain properties from conversion at the end of the 12 year period after commencement of the LTO by way of making amendments to Schedule 4 of the LTO (i.e. making consequential amendments to the LRO). The mechanism for achieving such effect is proposed to be a “Registrar’s caution against conversion”. Once such a caution is registered, the affected property will not be converted on the day set for automatic conversion. After registration, affected parties could make representation to the Registrar or seek a Court order to have the caution removed. Until a Court order was given or the Registrar was satisfied that the caution could be removed, the property would remain governed by the LRO and would not be converted to the title registration system.

7. To address the financial risk in the period immediately after conversion (paragraph 3(b) above), in order to give assurance that the LRTF will not be exposed to instability that will adversely affect users of its services after conversion, the Government will take measures, appropriate to any liability arising out of the conversion, to ensure that those liabilities are met and charges on users of the registry services can be managed in an orderly manner. Approval for any capital payment required at the time would be sought from the Finance Committee of the day.

Modification of the 2008 Alternative Proposal

8. The objections to the conversion mechanism under the 2008 alternative proposal focussed on the upgrading process. The fact that it would be voluntary, paid for by individual applicants and uncertain in duration and outcome gave rise to concerns over potential cost, over failure to ensure that the objective of securing comprehensive conversion within a clear time frame would be achieved, and over uncertainty for owners and complexity for lawyers handling conveyancing. The only modification that could adequately address these objections would be to make the upgrading process automatic, without any requirement for application, investigation or additional charges.

9. If the 2008 alternative proposal were to be modified by making upgrading automatic, it will no longer be able to address all of the issues raised with the 2004 conversion mechanism. The effect will be as follows –

- (a) known cases of indeterminate ownership could not be screened out at the time of upgrading. To deal with these, a mechanism similar to a Registrar's caution against conversion as suggested under the 2004 conversion mechanism in paragraph 6 above would be needed; and
- (b) the risk to the LRTF from undetected liabilities after upgrading would remain. An undertaking similar to that outlined in paragraph 7 above for the 2004 conversion mechanism would be needed to give assurance of stability.

Comparison of Modified 2004 versus Modified 2008 Schemes

10. At Annex is a table setting out a comparison of modifications to the two captioned schemes, as set against the issues raised with the enacted mechanism and an assessment of the views of key parties. Both approaches can reasonably address the major issues outlined in paragraph 3(a) and (b) above.

11. A modified 2008 alternative proposal does not appear to offer any significant advantage over modifications that can be made to the "Daylight Conversion" mechanism. It would have to incorporate the changes required within the "Daylight Conversion" mechanism in order to address key issues. However, even if the 2008 alternative proposal were modified in this way, the underlying objection from many parties to changing the essential framework of the 2004 conversion

mechanism is likely to remain. On the other hand, there is reasonably widespread recognition of the need for some modification of the “Daylight Conversion” mechanism and generally similar views as to the type of modifications that would be appropriate. These modifications would address the most significant concerns that have been raised with the enacted provisions. On balance, we recommend that we should uphold the spirit of automatic conversion at the end of 12 years and manage those identified risks by proceeding to amend the LTO to modify the “Daylight Conversion” mechanism stipulated under the Ordinance enacted in 2004.

RECTIFICATION

12. Rectification refers to how the legally authoritative title register can be put right if it is found to be in error. Indemnity is the compensation that will be paid to an innocent party if it suffers loss after relying on the register and the loss cannot be avoided through rectification. Under the LTO enacted in 2004, any innocent owner removed from the register by fraud will be restored as owner provided that an action for recovery is taken within the time allowed by the Limitation Ordinance (Cap. 347), irrespective of any subsequent transactions or developments affecting the land. This is termed mandatory rectification, which is stipulated in the LTO to ensure that an innocent former owner will always get back his land in fraud cases. In the 2008 alternative proposal, on rectification, three exceptions to the mandatory rectification rule were proposed –

- (a) where the land had been surrendered to or resumed by the Government prior to discovery of a fraud, because it is practically impossible to have the title rectified in favour of an innocent former owner when the old title had been extinguished;
- (b) where the property had been divided up and sold on to multiple bona fide new owners prior to discovery of a fraud, otherwise all the titles created have to be rectified, leading to a multiplicity of claims from the displaced owners. Where a property is redeveloped, the original property is no longer there such that there is not the same property that can be restored to the innocent former owner. The innocent former owner would also be unduly enriched by any improvements made; and
- (c) where the bona fide registered owner for value at the time of discovery of the fraud was not the first person to have been registered as owner since the fraud. Otherwise, a current owner named in the title register would face the risk of being displaced by an innocent former owner if

a fraud is established in the previous transactions.

13. With respect to the *rectification provisions*, two points are clear from the consultation exercise –

- (a) there is understanding of the complications for the mandatory rectification rule arising from surrender, resumption or redevelopment of land prior to discovery of a fraud (paragraph 12(a) and (b) above) but a strong view that, if any modification is made to deal with this, the imposition of a cap on indemnity would have to be reconsidered to protect an innocent former owner who did not recover the property; and
- (b) there was widespread reluctance to give stronger protection to a purchaser who had not dealt with the fraudster (paragraph 12(c) above). It is thought that the mandatory rectification rule should remain unchanged in this context, irrespective of the distance of the current registered owner from the fraudulent transaction.

Revised Proposal

14. Regarding paragraph 12(a) above, respondents generally accepted that there is a practical impossibility of restoring an innocent former owner to a title that has been extinguished, but concern that if this exception is allowed an innocent former owner risks being deprived of full monetary compensation for the loss. To be consistent with the undertaking given in 2004 that an innocent former owner should not be put at risk of being left worse off under the new system than under existing law, if the exception is to apply, the exclusion of indemnity for pre-conversion fraud² and the cap on indemnity to an innocent former owner affected by the exception would have to be removed.

15. Regarding paragraph 12(b), the justification for preventing rectification to the innocent former owner simply only on the grounds that the property had been acquired by multiple new owners was questioned. Argument was made that unless redevelopment was involved, the property should still be returned to the pre-fraud owner, irrespective of multiple new owners having been created. On further consideration we accept that the element of redevelopment should be an essential

² Under the LTO enacted in 2004, no indemnity will be paid for cases where the fraud happened before conversion but the innocent former owner will always get back his land. However, for the exception cases under consideration, as the innocent former owner cannot get back the land, he will get no compensation at all if the bar on pre-conversion fraud remains.

part of the test if the exception is to be made. We propose that this exception will be limited to cases where there has been both redevelopment and onward-sale to multiple new owners and it is inequitable to deprive these new owners of their titles by restoring title to the innocent former owner. Again, to be consistent with the undertaking given in 2004 that an innocent former owner should not be put at risk of being left worse off under the new system than under existing law, if the exception is to apply, the exclusion of indemnity for pre-conversion fraud and the cap on indemnity to an innocent former owner affected by the exception would have to be removed.

16. Regarding paragraph 12(c), most respondents to the consultation exercise held the view that it was right in principle to give most security to the innocent former owner, rather than to give further consideration to the position of purchasers. We note that this view is at variance with the principles followed in other jurisdictions with title registration regimes but, given the strong position taken by respondents on this issue, and on the assessment that it is not a critical issue at this stage, we do not intend to pursue this exception in the context of the Land Titles (Amendment) Bill. If concern about the position of a purchaser after fraud is found to impact on the operation of the conveyancing system at a later date it will be possible to review this particular provision without impact on other aspects of the legislation.

ADVICE SOUGHT

17. In summary, Members are invited to consider whether the following proposed modifications to the 2004 conversion mechanism and revised proposal on rectification should be adopted –

- (a) on conversion, we proceed with amendments based on the “Daylight Conversion” mechanism stipulated under the LTO enacted in 2004, that is, we will not pursue the alternative scheme proposed in 2008 or contemplate modifications to it (paragraph 11 above);
- (b) specifically, new provision will be made to enable the Registrar to register a “Registrar’s caution against conversion” to deal with known cases of indeterminate ownership (paragraph 6 above);
- (c) the Government will take measures, appropriate to any liability arising out of the conversion, to ensure that those liabilities are met and charges on users of the registry services (including the levy to be introduced under LTO) can be managed in an orderly manner

(paragraph 7 above);

- (d) on rectification for fraud cases, the mandatory rectification rule will not apply only where the land had been surrendered to or resumed by the Government prior to discovery of a fraud, or where the property had been redeveloped and sold on to multiple bona fide new owners prior to discovery of a fraud (paragraphs 14 and 15 above);
- (e) to lift the exclusion of indemnity for pre-conversion fraud and the cap on indemnity to the innocent former owner in the exceptional scenarios in (d) above (paragraphs 14 and 15 above); and
- (f) not to pursue the 2008 proposal to give stronger protection to a purchaser who had not dealt with the fraudster (paragraph 16 above).

NEXT STEP

18. Subject to any comments from Members, we will further consult the stakeholders on the revised proposals with a view to drafting amendments to the LTO and introducing the amendments to the LegCo at the earliest opportunity.

**Development Bureau
June 2009**

Comparison Table

2004 Conversion Mechanism	Modified 2004 Conversion Mechanism	Modified 2008 Alternative Proposal	Assessment of Main Stakeholder Reactions
<p><u>Main Features</u></p> <p>(1) On commencement of LTO, title registration applies only to new land</p> <p>(2) Existing land remains under modified LRO provisions for 12 years</p> <p>(3) At end of 12 years, conversion of eligible land is automatic unless a valid caution against conversion subsists or an instrument is pending registration</p>	<p>As enacted</p> <p>As enacted but with additional amendment to LRO for “Registrar’s caution against conversion”</p> <p>As enacted but registers covered by “Registrar’s caution against conversion” are also withheld from conversion.</p>	<p>As enacted</p> <p>Existing land remains under LRO for about 3 years. No further amendment to LRO.</p> <p>Existing land converts to LTO after 3 years but remains subject to subsisting interests.</p> <p>After 12 years, converted land automatically upgraded to full title.</p>	

2004 Conversion Mechanism	Modified 2004 Conversion Mechanism	Modified 2008 Alternative Proposal	Assessment of Main Stakeholder Reactions
<p><u>Issues with enacted mechanism</u></p> <p>(1) No means to deal with known cases of indeterminate ownership</p> <p>(2) Financial risks to Government after conversion</p>	<p>New provision for “Registrar’s caution against conversion” would remove this problem.</p> <p>Government will ensure that liabilities can be met if they arise, and charges on users of land registry services managed in an orderly manner.</p>	<p>Change from investigation of title before upgrading to automatic upgrading would mean that provisions for a “Registrar’s caution against upgrading” would need to be added to the LTO if this problem is to be dealt with.</p> <p>Government will ensure that liabilities can be met if they arise, and charges on users of land registry services managed in an orderly manner.</p>	<p>The idea of excluding certain properties from conversion under the “Daylight Conversion” mechanism is acceptable if exercised carefully. This is strongly preferred to incorporating exclusion provisions in modified 2008 alternative proposal.</p> <p>Either approach acceptable as it does not lead to an additional charge to owners. Strong preference to make financing change within the framework of “Daylight Conversion” mechanism.</p>