

**BILLS COMMITTEE ON
LAND TITLES BILL**

INDEMNITY

Purpose

This paper sets out the objectives and operation of the indemnity scheme envisioned in the Land Titles Bill. It also addresses the question of whether a cap on the payments under the scheme is legally in order.

Background

2. At present, under the Land Registration Ordinance, the Land Registry is liable for any losses arising from negligence on the part of the Registry. However, the Ordinance provides no assistance to innocent parties who lose ownership of their property because of fraud or the operation of the Ordinance. Whichever party is not awarded the property – usually the purchaser - is left to attempt to recover their loss from the fraudster.

3. The major safeguards against losses due to fraud lie in the conveyancing system with its requirements for careful checking of identity and authority to conduct transactions. This will remain under the title registration system. However, the title registration system will provide an additional safeguard in the form of an indemnity scheme.

4. The indemnity scheme proposed in the Land Titles Bill would allow for a cap to be placed on the maximum payment that can be made in any fraud case. Current plans are that the cap should be set at \$30 million. There are queries as to whether such a cap is constitutional on the grounds that it may deprive a person of their property without full compensation as provided for under Articles 6 and 105 of the Basic Law.

The Scheme

5. It is proposed to set up an indemnity fund to meet claims. The fund will be financed by a levy on registrations, by payments from the Land Registry Trading Fund in the case of losses caused by mistakes or omissions by the Registry, and by action to recover money from parties who have contributed to losses by their fraud or negligence

and the losses have been compensated for by the indemnity fund. It is intended that the levy will adopt a tiered rate structure, reflecting the average value of various bands of property. The levy rates would be set with the aim of maintaining the fund on a self-standing basis. Subject to the Finance Committee's approval, however, the Government intends to make available a stand-by loan to be drawn on if there are substantial claims in the early years before the fund has established reserves of its own to draw on.

6. Claims for indemnity can be made under two circumstances:

- (a) loss caused by an entry in or omission from the Title Register as a result of mistakes or omissions on the part of the Land Registrar or public officers assisting the Registrar (Clause 82(1)(b)); and
- (b) loss of ownership caused by an entry in or omission from the Title Register as a result of fraud (Clause 82(1)(a)).

7. As regards para. 6(a), a claimant may be entitled to indemnity if an entry has been obtained or omitted from the Title Register as a result of any mistake or omission of the Land Registrar or his officers. There will be no cap on the indemnity. In effect this is the same position as under the existing deeds registration system. The indemnity fund would simply be the mechanism through which the compensation payment was made. The Land Registry Trading Fund will have to pay the indemnity fund for the loss.

8. As regards para. 6(b), the fraud may have been committed by any person, but it must affect the ownership of registered land or the registration of a person as the lessee of a registered long term lease. Also, a Court Order must have been made under Clause 81(1) or Clause 81(3).

9. A Court order is required before payment from the indemnity fund is considered. The Courts have the power to call all the witnesses and consider all the evidence to assess whether a fraud has been committed. Furthermore, where there are two valid claimants to a property after a fraud by a third party, the Court has to direct who is to hold the property before indemnity payments can be considered for the other claimant. Clause 82(6) confirms that a registered owner who is deprived of the property by a Court order is eligible to make a claim from the indemnity scheme.

10. Clause 82(2) prevents payment being made to anyone who has caused or substantially contributed to the loss by his fraud or negligence. This provision is to guard against any collusion between the owner and fraudster or any purchaser failing to check any suspicious circumstances arising in his transaction. It also prevents payment to anyone who has derived title from the person who has contributed to the loss by his fraud or negligence, with the exception of a bona fide purchaser for value. This provision is needed in order to guard against a purchaser with knowledge of fraud and a person not paying any value for the land (that is, donee under a gift) to claim against the indemnity.

11. The provision in Clause 82(3) is to safeguard against claims being made where a loss has been caused due to a party outside the Land Registry withholding a matter that should have been registered. Action in such cases should lie against the party concealing the instruments from registration.

12. Express provision is made to exclude claims by professional indemnity insurers. This is for the avoidance of doubt that professional indemnity insurers, rather than the Indemnity Fund, will compensate persons who suffer loss caused by members of a profession.

13. The most important cases where the indemnity scheme would come into operation are those where there are two valid competing claims over one property. This would be if there is an innocent former owner deprived of ownership of the property by fraud and an innocent purchaser who has paid full value for the property without knowledge of the fraud. Only one claim can be satisfied by holding the property.

14. Under present arrangements an innocent former owner can usually expect to be able to recover the property even where an innocent purchaser has paid fair value for the property and is in possession. An innocent purchaser is usually left to pursue the fraudster to recover the loss and has to move out even if he has already taken possession of the property. Under the proposed system, the situation of an innocent former owner and an innocent purchaser would be changed as follows: -

(a) The purchaser is not in possession

The former owner will regain the property if the Court orders a rectification of the Title Register in his favour under Section 81(1) of the Land Titles Bill. The innocent purchaser will be able to make a claim against the indemnity fund.

(b) The purchaser is in possession

The innocent former owner will not recover the property unless a Court directs otherwise. He (or the innocent purchaser if the Court orders rectification to the former owner) will be able to make a claim against the indemnity fund.

15. The overall scheme under the Land Titles Bill, combined with the operating procedures of the Land Registry, the Law Society's practice guidance, and checks by solicitors firms and banks, is intended to keep the risk of successful fraud in relation to property to the minimum. The indemnity scheme will only be called on if all preventive measures and precautions have failed.

16. In most conceivable cases, even with the cap on payments, the amount that would be available to a claimant would fully cover all his loss. The indemnity fund

would take over his claim against the fraudster. Even if a loss exceeded the cap amount, a claimant would have the assurance of being able to recover at least that amount. This is an assurance that he does not have under present arrangements. He will also retain the right to pursue claims for recovery of amounts exceeding the indemnity cap from the persons committing the fraud.

Constitutionality of the Cap

17. It has been suggested that the Bill attempts to deprive an innocent owner of his property without full compensation and is thereby contrary to the Basic Law, specifically BL 6 and 105.

18. BL 6 provides that the Hong Kong Special Administrative Region (“HKSAR”) shall protect the right of private ownership of property in accordance with law.

19. BL 105 provides that the HKSAR shall, in accordance with law, protect the right of individuals and legal persons to the acquisition, use, disposal and inheritance of property and their right to compensation for lawful deprivation of their property. Such compensation shall correspond to the real value of the property concerned at the time and shall be freely convertible and paid without undue delay.

20. The right to compensation only arises when there is a lawful deprivation of property for the purpose of BL 105. The key question, therefore, is whether the scheme proposed in the Land Titles Bill deprives property for the above purpose.

Deprivation

21. The proposed scheme under the Bill is a general scheme which determines whether a substantive ownership of land is free of any incumbrances and the priority between two or more incumbrances in land. The Land Titles Bill provides for how legitimate, competing private claims to a single property are to be dealt with. With this in mind, the question posed in paragraph 20 above should be answered in the negative in view of the following:

- a) the provisions of the Joint Declaration on the right to compensation for lawful deprivation of property;
- b) the current land registration system which predates the establishment of the HKSAR; and
- c) the comparative jurisprudence of Australian Courts and that under Article 1 of the First Protocol of the European Convention on Human Rights (ECHR), both on protection of property rights.

Continuity

22. It is established that the Joint Declaration may be used as a guide to the interpretation of the Basic Law. The part of the Joint Declaration corresponding to BL 6 and BL 105 is Section VI of Annex I. This provides that: "rights concerning the ownership of property, including those relating to acquisition, use, disposal, inheritance and compensation for lawful deprivation...shall continue to be protected by the law." It is clear from this that the right to compensation for lawful deprivation of property under BL 105 basically mirrors the right to compensation for lawful deprivation of property prior to the reunification. If certain interference with property rights did not give rise to any right to compensation before the reunification, it is unlikely that it would be within the scope of "deprivation" for which compensation is payable under BL 105.

23. This is reinforced by the theme of continuity in the Basic Law. As decided by the Court of Appeal in *HKSAR v Ma Wai Kwan David* [1997] HKLRD 761, at 790D and 800J, the whole tenor of the Basic Law, following the Joint Declaration, is to establish continuity save for those changes necessary upon the Chinese resumption of sovereignty.

Pre-existing Law

24. Under the present land registration system, operating since 1844, interests in land can be rendered unenforceable in certain circumstances. No compensation would be paid by Government for the loss of such interests due to the operation of this system. An example of this is:

An owner, A, has made a lease of over 3 years in favour of B, but this lease is unregistered. If A were to sell the property to C, who is a bona fide purchaser for value, B would lose his interest in the land. This is because s.3(2) of the Land Registration Ordinance provides that an unregistered instrument is void and of no effect against a bona fide purchaser for value. The only recourse B has is a personal right of remedy against A.

Comparative Jurisprudence

25. Further, the jurisprudence of the Australian Courts and that under Article 1 of the First Protocol of the ECHR support that a law which is not directed towards deprivation as such but is concerned with the adjustment or regulation of competing private property claims is unlikely to be susceptible of legitimate characterization as a law which deprives property for the purpose of BL 105.

26. Section 51 (xxxi) of the Australian Constitution provides for a guarantee of property rights. However, the Australian courts have held that laws which are not directed at the acquisition of property as such but are concerned with the adjustment of

competing rights, claims or obligations of persons in a particular relationship or area of activity are beyond the reach of the constitutional guarantee of "acquisition on just terms". [Peter Hanks: *Constitutional Law in Australia* (2nd Ed. 1996) p.510]

27. In the case of Article 1 of the First Protocol of the ECHR, jurisprudence under that Article has held that the 'deprivation' of property with which it is concerned is directed against expropriations by the State, or authorized by the state for public purposes. It is not directed against matters which are essentially ones of private law [See *Bramelid v Sweden* (1982) 5 EHR 249, recently followed by the English High Court in *Family Housing Association v Donnellan* [2002] 1 P&CR 34]. It may be noted that in the recent case of *Kowloon Poultry Laan Merchants Association v Department of Justice* [CACV 1521/2001] the Hong Kong Court of Appeal has relied on the decision of the European Commission of Human Rights in *Baner v Sweden* [60 DR 128] to construe the meaning of "deprivation of property" under BL 105.

Fair Balance

28. While the scheme proposed under the Land Titles Bill does not deprive persons of their property for the purposes of BL 105, it will interfere with or control ownership of property rights in land. There is a further question, therefore, as to whether such interference or control is consistent with BL 6 and BL 105.

29. The term "in accordance with law" in BL 6 and 105 indicates that the property rights protected are subject to restrictions provided by the law and which are consistent with the Basic Law.

30. In the jurisprudence developed under the ECHR, a fair balance needs to be struck between the general interests of society – which any interference with or control of property rights must aim to serve – and the protection of the individual's property rights. Assuming that BL 6 and 105 are subject to this fair balance test, the Administration is of the view that the scheme proposed in the Land Titles Bill satisfies the test for the following reasons.

- a) The proposed system enhances certainty and will simplify conveyancing, which will bring widespread benefits.
- b) The proposed system will provide added security through the indemnity scheme in cases of fraud, mistake or omission.
- c) The proposed maximum amount of indemnity of HK\$30 million available under the scheme will be sufficient to provide full coverage to well over 99% of transactions.
- d) Where the scheme is insufficient to meet the full extent of the loss it does not take away the right that individuals now have to seek personal remedy against the third party fraudster and, by giving assurance of recovery of up

to the cap amount puts the party taking the action in a stronger position to pursue it.

- e) A cap on payment from the indemnity fund is reasonable in order to-
 - i) allow for a simple system to assess the levy on each property;
 - ii) maintain a stable and predictable levy scheme; and
 - iii) ensure that the levy rate is affordable with respect to all levels of property transactions.
- f) A cap is also reasonable given the greater capacity of owners of higher value property to take further steps to safeguard their interests if they think necessary.
- g) The right to an indemnity and the amount to be paid may be determined by the court.
- h) The proposed system provides a variety of ways in which equitable interests can be safeguarded against loss-
 - i) if it is an overriding interest, it is protected automatically;
 - ii) in cases of first registration following voluntary conversion or assignment without valuable consideration, any existing and enforceable interests immediately prior to first registration remain enforceable;
 - iii) a 'caution' may be entered to protect the position of a holder of equitable interests;
 - iv) an application may be made to the courts for rectification of the register (though, subject to the court's discretion, this remedy is not available against a bona fide purchaser for value who is in possession);
 - v) an application may be made to the courts to inhibit dealings, or the the Registrar to restrict dealings; and
 - vi) a holder of equitable interests may have a personal remedy against the present or previous registered owner resting upon his rights in contract or otherwise.

Conclusion

31. The Administration is of the view that the scheme proposed in the Land Titles Bill does not deprive any person of his property within the meaning of BL 105 but,

as in the case of the existing Land Registration Ordinance, it sets out arrangements for the regulation of competing private claims to property. It changes the arrangements to give greater certainty to registered land title but this is considered justified since:

- a) it prevents many existing blights on title being perpetuated and will allow interests in land to be handled with greater certainty, convenience, speed and cost effectiveness, to the general benefit of society; and
- b) it provides extensive means for private individuals to protect their interests.

Housing, Planning and Lands Bureau
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