

**Subcommittee on Building Management
(Third Party Risks Insurance) Regulation**

Matters Arising from Meeting on 23 October 2007

At the meeting of the Subcommittee on 23 October 2007, Members raised a number of questions about the Building Management (Third Party Risks Insurance) Regulation (the Regulation). Below are the responses of the Administration to these questions.

Reasonable Diligence under Section 6

2. During the discussion of the Regulation, some Members expressed concerns over the definition of the term “reasonable diligence” under section 6(3) of the Regulation and whether the insurance company may easily refuse to pay compensation to the third parties on the ground that the owners’ corporation (OC) has not exercised reasonable diligence to keep the building in good condition. As liability arising from unauthorized building works (UBWs) have already been excluded, in order to provide better protection for the third party, they considered that in the case where the OC has not exercised reasonable diligence to keep the building in good condition and thus caused the death of or bodily injury to a third party, the insurance company should be required to pay compensation to the third party first. The insurance company may then recover the sum from the OC concerned. This is similar to the practice with other compulsory insurance like the motor vehicle insurance.

3. Having considered Members’ views, we have further consulted the Hong Kong Federation of Insurers (HKFI). As advised by the HKFI, having a clause to require the OC to exercise reasonable diligence to keep the building in good condition is to reinforce the message that even with an insurance policy in force, the OC should still carry out its basic duties to properly manage and maintain their own properties. Should the insurance company be required to pay compensation to the third party first even though the OC has failed to exercise reasonable diligence to keep the building in good condition, the HKFI is concerned that some OCs may not make an effort to keep the buildings in good condition once they have procured an insurance policy. This may increase the number of claims and the risks borne by the insurance companies and in turn cause the average insurance premium in the market to increase. This will mean cross-subsidy of poor risks by good risks, which is unfair for those OCs who have kept their buildings in good condition.

4. That said, we are open to Members' views. Should Members maintain the view that the insurance company should pay the third party first and recover the sum from the OC concerned if the OC has not exercised reasonable diligence so as to provide better protection for third party, section 6(3) and (4) of the Regulation will have to be deleted. With such a deletion if an insurance policy restricts the insurance of the OC as respects the prescribed liability under the Regulation by reference to matters such as the condition or maintenance of the building, the use of the building and the existence of a statutory instrument in relation to the building, such restrictions are of no effect. In the face of a third party's claim, the insurance company has to pay compensation to the third party first. It may then recover the sum from the OC in accordance with section 6(6) of the Regulation.

Section 9(5)

5. Some Members have enquired about section 9(5) and are concerned whether the insurance company would tend to claim that the OC has obtained the policy by not disclosing the existence of UBWs and thus refuse to pay compensation to the third party.

6. Section 9(5) of the Regulation is modelled on section 10(3) of the Motor Vehicles Insurance (Third Party Risks) Ordinance (Cap. 272). It provides that an insurance company is not required to satisfy a judgment under section 8 if it has obtained a declaration, from the court in an action commenced in the stipulated period, that it is entitled to avoid the insurance policy on the ground that the policy was obtained by the non-disclosure of a material fact or by a representation of fact which was false in some material particulars.

7. It is important to point out that under the common law, an insurance company may already avoid an insurance policy which is obtained by non-disclosure or misrepresentation of a material fact. Under the law of contract, a misstatement by one party by which the other is induced to enter into a contract will generally entitle the latter to avoid the contract. An insurance policy is a contract of the utmost good faith, and the law demands a higher standard of good faith. There is also a duty of disclosure to the other party all facts of which he is aware and which may affect that other's judgment in determining whether to enter into the contract or in determining the terms of the contract. A breach of the duty by one party will also entitle the other to avoid the contract. Section 9(5) therefore is similar to existing common law position.

8. To protect the interests of the third party, it is stipulated under section 9(5) that the insurance company has the burden to successfully obtain a declaration from the court before it can avoid the policy. It is therefore for the court to decide whether there is a non-disclosure or misrepresentation of a material fact to the extent that it warrants the avoidance of the insurance policy by the insurance company. The insurance company cannot unilaterally declare that the policy was obtained by non-disclosure or misrepresentation of a material fact and thus refuse to satisfy judgements in respect of third party risks under section 8 of the Regulation.

9. To further safeguard the interests of the third party, section 9(6) provides that the insurance company is not entitled to the benefit of section 9(5) unless it has given notice of the action to the third party concerned before, or within 7 days after, the commencement of the action. The notice has to specify the non-disclosure or false representation on which the insurance company proposes to rely. The third party concerned is entitled to be made a party of such action.

10. Some Members have expressed concerns over a situation where the OC may not know about the existence of a UBW and hence make a false statement in procuring an insurance policy to the insurance company. As advised by the HKFI, if the OC is uncertain of whether there are UBWs in the building, it should inform the insurance company that it does not know or is unsure about whether there are UBWs in the building. Such a statement does not amount to non-disclosure or misrepresentation of facts.

11. Members have enquired what types of information are required by the insurance company in considering the application for insurance policy. As advised by the HKFI, different insurance companies may require different types of information in considering the application. However, in general, OCs will be required to provide information such as the location of the building, the age of the building, the use of the building, the number of blocks/storeys/flats in the building, whether there is management company, whether there are any club house or swimming pool, whether there is any illegal structure, whether there is any lift etc.

Displaying Notice of Insurance

12. Section 5(3) of the Regulation requires an OC to display the

notice of insurance in a prominent place in the building as long as the policy is in effect. The purpose of this provision is to allow the owners of the building to check whether the OC has procured the mandatory third party risks insurance policy. If an OC contravenes the requirement, every member of the management committee (MC) is guilty of an offence and is liable on conviction to a fine at level 2. Should an MC member prove that the offence was committed without his consent or connivance; and that he has exercised all such due diligence to prevent the contravention as he ought to have exercised in the circumstances, he will not be guilty of the offence.

13. For Members' reference, in accordance with section 11(1) of the Building Management Ordinance (BMO), an MC is required to display a copy of the certificate of registration of the OC in a prominent place in the building. As stipulated in section 11(3) of the BMO, in the event of a contravention of this requirement, every member of the MC shall be guilty of an offence and shall be liable on conviction to a fine of \$50 unless he proves that the offence was committed without his consent or connivance and that he has exercised all such due diligence to prevent the commission of the offence as he ought to have exercised in having regard to the nature of his functions in that capacity and to all the circumstances.

Unauthorized Building Works

14. UBWs include any building erected in contravention of the Buildings Ordinance (Cap. 123) or any building works or street works carried out in contravention of the Buildings Ordinance. Under the current enforcement policy on UBWs, the Buildings Department will take immediate enforcement action against UBWs that are newly built or posing an imminent danger to life or property. For other UBWs, the Buildings Department will consider issuing warning notices or advisory letters to the owners concerned. If the UBWs are not demolished within a specified timeframe, the Buildings Department will register the warning notices in the Land Registry.

Home Affairs Department
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