FACV No. 4 of 2005

IN THE COURT OF FINAL APPEAL OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION

FINAL APPEAL NO. 4 OF 2005 (CIVIL)
(ON APPEAL FROM CACV NO. 458 OF 2002)

Between:

CAPITAL WELL LIMITED **Appellant**

- and -

BOND STAR DEVELOPMENT LIMITED **Respondent**

Court: Mr Justice Bokhary PJ, Mr Justice Chan PJ, Mr Justice Ribeiro PJ, Mr Justice Nazareth NPJ and Lord Millett NPJ

Hearing and Decision: 20 October 2005

Handing Down of Reasons: 2 November 2005

J U D G M E N T

Mr Justice Bokhary PJ:

1. At the conclusion of the hearing we announced that, for reasons to be handed down later, the appeal was dismissed with the result that the Court of Appeal's order for sale, confined to the sale of No. 28 Ming Yuen Western Street, was affirmed. The respondent asked that the orders as to costs made

below be affirmed and that it be awarded costs here. That was not resisted by the appellant, and we so ordered. We now hand down our reasons for dismissing the appeal. They are given by Mr Justice Ribeiro PJ for the Court.

Mr Justice Ribeiro PJ:

2. The Land (Compulsory Sale for Redevelopment) Ordinance, Cap 545 ("the Ordinance") aims to facilitate urban renewal in the context of private sector land redevelopment. Where buildings on a lot are of an age or state of repair justifying redevelopment, it permits a person owning at least 90% of the undivided shares in the lot, who has failed to acquire the balance of the undivided shares despite having made appropriate efforts to do so, to apply to the Lands Tribunal ("the Tribunal") for a compulsory order requiring sale of the lot for the purposes of redevelopment.

3. The respondent obtained such an order from the Tribunal over resistance by the appellant (LDCS 2000/2001, 5 December 2002, Deputy Judge Wong and Mr W K Lo). The latter's appeal was unanimously dismissed by the Court of Appeal (CACV 458/2002, 19 September 2003, Rogers VP, Yeung and Yuen JJA). Leave to appeal to this Court was granted by the Court of Appeal.

The facts

4. The respondent is a property developer. In 1993, with redevelopment in mind, it set about acquiring units in multi-ownership in five contiguous tenement buildings occupying six separate lots at Nos 24, 26, 28, 30 and 32 of Ming Yuen Western Street in North Point. In the middle of this row of properties was the lot with which we are primarily concerned, known as the Remaining Portion of Sub-Section 8 of Section B of Inland Lot No 897 ("the Lot"). On it stood the building at No 28 Ming Yuen Western Street.

5. The Lot was notionally sub-divided into six undivided shares, with one undivided share allocated to each of the premises situated respectively in the basement and on the ground, first, second, third and top floors. The premises which concern us involve the flat on the 3rd Floor of No 28 ("the Premises"). A half-interest in the undivided share allocated to the Premises had previously been owned by Madam Lo Yin who died intestate and whose half-interest passed on her death to her three surviving sisters ("the Lo sisters"). The other half-interest was owned by one Pon Mok Yuet Ming ("Madam Pon").

6. In August 1993, the respondent acquired Madam Pon's half-interest for $2.7 million. The Lo sisters were then already of advanced age and resided on the mainland. Through an intermediary, a solicitor's conveyancing clerk named Joseph Cheung Chan Ka ("Mr Cheung"), the respondent managed in 1995 to acquire their beneficial interest in the half-share for $870,000. Mr Cheung also persuaded them to authorize him to apply for letters of administration for Madam Lo's estate in Hong Kong.

7. Having completed the acquisition of the six lots by the end of 1995, the respondent had all the buildings demolished in 1996. However, in January 1997, the Lo sisters brought proceedings in the Court of First Instance against Mr Cheung and the respondent and successfully obtained orders setting aside the agreement for sale of their half-interest in the Premises on the ground that it was an unconscionable agreement (see *Lo Wo & Others v Cheung Chan Ka & Another* [2000] 2 HKLRD 370, Waung J). The 50% interest in the Premises therefore reverted to Madam Lo's estate. Waung J's decision was upheld in the Court of Appeal (see *Lo Wo & Others v Cheung Chan Ka & Another*, CACV 217 of 2000, 31 May 2001, Rogers VP and Keith and Le Pichon JJA).

8. Subsequently, the letters of administration were amended to name Cai Shi as Administrator of Madam Lo's estate and, in July 2000, the appellant purchased the half-share in the Premises from the estate for $2.4 million.

9. In June and July 2001, the respondent made a series of offers to the appellant for the purchase of that half-share, culminating in an offer made on 26 July 2001 to buy the same for $2.5 million. The appellant made a counter-offer to sell for $15 million. The gap appeared unbridgeable and the present proceedings were begun on 13 August 2001.

The scheme of the Ordinance

10. An application which results in a compulsory sale under the Ordinance has four distinct phases: (i) the application; (ii) the Tribunal's determination; (iii) the sale; and (iv) apportionment and application of the proceeds of sale.

(i) The application

11. Section 3(1) lays down the conditions for making an application. It relevantly states:

> "..... the person or persons who owns or own ... not less than 90% of the undivided shares in a lot may make an application –
>
> (a) accompanied by a valuation report as specified in Part 1 of Schedule 1; and
>
> (b) to the Tribunal for an order to sell all the undivided shares in the lot for the purposes of the redevelopment of the lot."

12. A "lot" is defined to mean "any piece or parcel of ground the subject of a Government lease" and includes "a section and subsection of a lot" (s 2). Where an applicant is eligible under s 3(1), he is referred to as a "majority owner" in relation to the relevant lot (s 2). The person who owns the

remaining undivided shares is referred to as the "minority owner". An application may be made by more than one person where they together hold at least 90% of the undivided shares. And the "minority owner" may consist of several persons who each own interests in the undivided shares not already owned by the applicant (s 2). The Ordinance also caters for an application to be made by a majority owner in respect of more than one lot (s 3(2)(a)) but for present purposes, it will be convenient to discuss the provisions of the Ordinance with reference to a single majority owner, a single minority owner and a single lot.

13. Schedule I, Pt 1 sets out the requirements of the valuation report which must accompany the s 3(1) application ("the s 3(1) report"). It must have been prepared not more than 3 months beforehand and must assess the market value of each property on the lot sought to be sold, on a vacant possession basis, ignoring the possibility of a compulsory order under the Ordinance and ignoring the redevelopment potential of the property or the lot. The s 3(1) report therefore contains a valuation of each unit owned respectively by the majority and minority owners in the original development. It does not address the value of the projected redevelopment. As further discussed below, the purpose of the s 3(1) report is to provide the basis for apportioning any future sale proceeds between the majority and minority owners.

(ii) The Tribunal's determination

14. Upon receipt of an application it falls to the Tribunal to decide whether a compulsory sale order should or should not be made (s 4(1)(b)). As a preliminary to that decision, if any dispute exists as to the assessments contained in the s 3(1) report, the Tribunal determines that dispute and, if necessary, adjusts the valuation in the light of the evidence (s 4(1)(a) and Sch I, Pt 3(b)).

15. There are two conditions which must be satisfied before the Tribunal can make a compulsory order:

(a) First, it must be satisfied that "the redevelopment of the lot is justified ..... due to the age or state of repair of the existing development on the lot" (s 4(2)(a)(i)).

(b) Secondly, it must be satisfied that "the majority owner has taken reasonable steps to acquire all the undivided shares in the lot (including, in the case of a minority owner whose whereabouts are known, negotiating for the purchase of such of those shares as are owned by that minority owner on terms that are fair and reasonable)" (s 4(2)(b)).

(iii) The sale

16. If those conditions are satisfied and the Tribunal decides to make the order, it appoints trustees to conduct the sale (s 4(1)(c)). Unless the parties all agree to some other method of sale approved by the Tribunal, the lot must be sold by public auction (s 5(1)). The Tribunal is empowered to give directions relating to the sale (s 4(6)).

17. The lot is sold to the highest bidder with any owner (whether majority or minority) being allowed to purchase (s 5(5)). However, the sale must be subject to a reserve price, approved by the Tribunal. That reserve price "takes into account the redevelopment potential of the lot on its own (or, where two or more lots are the subject of the auction, on their own)" (Sch 2, para 2).

18. An existing owner who successfully bids for the property is required to pay to the trustees only the amount calculated to cover the price attributable to the undivided shares which he does not already own (s 6).

(iv) Apportionment and application of the sale proceeds

19. The proceeds of sale and the associated expenses are apportioned between the majority and minority owners on a pro rata basis "in accordance with ..... the values of the respective properties of each majority owner and each minority owner of the lot" as assessed in the s 3(1) report, subject to any adjustments that may have been made by the Tribunal (Sch I, Pt 3). Thus, as noted above, the s 3(1) report is used for determining the percentage shares of each majority and minority owner in the proceeds.

20. The apportioned proceeds are then distributed by the trustees to the respective owners after deducting the sale expenses and legal costs, as well as sums to cover any liabilities to the government and to discharge any incumbrances on the property (s 11).

21. The objectives of the Ordinance underlying this four-stage process are clear. On the one hand, the Ordinance aims to facilitate urban renewal in respect of old and dilapidated buildings by assisting private developers to complete their acquisition where they already own at least 90% of the lot in question and by preventing the indefinite obstruction of a redevelopment by any minority owners who may seek to extract a wholly unreasonable price or "ransom" for permitting the redevelopment to proceed. On the other hand, it aims to ensure that the minority owner receives fair and reasonable compensation for his interest in the lot. Such compensation may be that which the minority owner agrees to accept or that which represents his share of the market value of the lot (reflecting its redevelopment value) as determined at a public auction, subject to a reserve price approved by the Tribunal.

The arguments on appeal

22. Mr Benjamin Chain, who appeared for the appellant, advanced two grounds of appeal. First, he contended that there was no jurisdiction to make an order for sale because the Ordinance does not apply to "vacant land". Secondly, he argued that the Tribunal was wrong to make an order because it should have held that the majority owner had failed to make an offer to purchase on fair and reasonable terms, as required by s 4(2)(b).

The "vacant land" point

23. Mr Chain poses the question whether the Ordinance applies to "vacant land". However, the Lot is more accurately described as a cleared site. On it had stood the building at No 28 (constructed in 1955) which, the parties agree, was of an age or state of repair justifying redevelopment. That building had only recently been demolished as part of the redevelopment project still being pursued by the respondent. Description of the land merely as "vacant" gives insufficient prominence to these pertinent facts.

24. Mr Chain based this part of his argument on the wording of s 4(2)(a)(i) which requires the Tribunal to be satisfied that "the redevelopment of the lot is justified ..... due to the age or state of repair *of the existing development on the lot*" before ordering a sale. He submitted that the italicised words stipulate that an order for sale can only be made when a development, ie, a building, still exists on the lot at the time of the application.

25. In common with the Court of Appeal (§§21-26), we reject that argument. Section 2 defines "redevelopment" as the process of replacing a building on the lot with a new building. When s 4(2)(a)(i) speaks of the "existing development" it is referring to the building which has already come

into existence, contrasting it with the proposed building which is not yet in existence and which is to replace the original building.

26. It matters not whether the original building is still standing at the time of the application. The fact that it may already have been demolished is catered for in the s 2 definition of "redevelopment" which states that, when used in relation to a lot, the word "redevelopment" means "the replacement of a building on *(or formerly on)* the lot". When s 4(2)(a)(i) provides that the Tribunal may be satisfied that redevelopment (ie, the replacement of the building on (or formerly on) the lot by another building) is justified "due to the age or state of repair of the existing development on the lot", it plainly intends the words "existing development" to embrace not merely an existing building but also a cleared site on which the dilapidated building had formerly stood.

27. It is no accident that the definition expressly extends to lots where the building intended to be replaced has already been demolished. The Ordinance is concerned with buildings which may well be in a serious state of disrepair and which might well require demolition on grounds of public safety at a time when a developer has not yet acquired the 90% interest needed to qualify as an applicant under the Ordinance. There is no conceivable reason of policy to exclude a developer who achieves the qualifying 90% interest only after the building has been pulled down in the interests of public safety. The objective of facilitating needed urban renewal applies equally to the cleared site which should not be left to lie fallow. It makes no difference that the building, which was always intended to be demolished and replaced (as the Ordinance envisages in all cases of redevelopment) happens already to have been demolished at the time of the application.

The reasonableness of the offer

28. Mr Chain sought to persuade the Court that the Tribunal was wrong to accept that the offer to purchase the appellant's interest for $2.5 million constituted an offer of purchase "on terms that are fair and reasonable" for the purposes of s 4(2)(b).

29. The Tribunal had made its finding on the basis of valuation evidence filed by both sides as to the open market value of all six lots, taking account of the composite site's redevelopment potential. The valuations put in by the respondent and appellant assessed such value at $106 million and $113.75 million respectively. The appellant's interest was calculated to be 2.16% of the whole, applying by analogy the s 3(1) report methodology of identifying a minority owner's percentage share in the original development.

30. On that basis, the appellant's proportionate share of the open market value of the overall site, came to $2,289,600 (on the respondent's evidence) and to $2,457,000 (on the appellant's evidence). The majority owner's offer of $2.5 million was therefore higher than each of those assessments and was accepted by the Tribunal to be fair and reasonable for the purposes of the section. This was upheld in the Court of Appeal.

31. Mr Chain argued that it was wrong simply to attribute a proportionate value, calculated at 2.16%, to the appellant's interest because this ignored what he termed "the strategic position" of the Lot which, he contended, made it disproportionately valuable. He argued that its situation in the middle of the row of lots intended to be redeveloped meant that a refusal to sell the Lot would prevent the respondent from realising the "marriage value" of redeveloping the entire row of lots (as opposed to embarking upon two smaller redevelopments separated by an undeveloped lot). Before the Tribunal (§§60-63), it was contended that a proper reflection of such marriage value

required the appellant's interest to be assessed at $3,377,500. Accordingly, so the argument ran, the Tribunal could not properly regard the $2.5 million offer as fair and reasonable.

32. In our view, that argument rests on a misconception as to the nature of the s 4(2)(b) requirement and must be rejected. As noted above, the Ordinance stipulates that before the Tribunal can make a compulsory order, the majority owner should try to reach agreement with the minority to purchase the latter's interest on fair and reasonable terms. It is only after such an offer is made – and rejected by the minority – that the Tribunal may proceed to order a sale by public auction. The Ordinance therefore recognizes that the minority is perfectly entitled to take its own view and to refuse to sell at the price offered even though the Tribunal may regard that price as fair and reasonable.

33. In making that assessment the Tribunal is not conducting a valuation exercise. It does not need to adjudicate upon any disputes about the correct valuation principles to be applied. It does not itself arrive at any conclusion as to what figure represents the correct valuation. It merely needs to be satisfied that, on the evidence available, the offer falls within the range of what may broadly be regarded as fair and reasonable compensation for the interest in question. It is obviously necessary to recognize that there will often be differences of opinion on that matter. If duly satisfied that the rejected offer was fair and reasonable, the Tribunal may make the order, leaving the value and level of compensation to be determined by the public auction. The auction results may prove that the minority's assessment was commercially wise. Or they may show that the majority's offer exceeded what was realised at the auction.

34. Once the purpose of s 4(2)(b) is understood, the error in the appellant's approach becomes apparent. Mr Chain sought to argue that the

Tribunal had erred in failing to recognize that a valuation of the minority owner's interest was obliged to take into account the Lot's "strategic position" and "marriage value". He submitted that any valuation which failed to attribute significant value to those features of the Lot over and above its proportionate value was wrong in principle and could not serve as a basis for judging whether the $2.5 million offer was fair and reasonable. As the Tribunal had relied precisely on such deficient valuation evidence, it was wrong as a matter of law. Mr Chain was therefore approaching the s 4(2)(b) exercise as if it required the Tribunal to decide first what the correct valuation was, and only then to assess the fairness and reasonableness of the majority owner's offer against the valuation carried out on correct principles.

35. We do not consider that the Tribunal is required to perform any such task. At most contested hearings, one may expect conflicting evidence as to value to be filed. The present case is a good illustration. The evidence as to how "marriage value" is to be assessed and how much of it should be attributed to the minority owner's interest was hotly disputed before the Tribunal. And while Mr Chain repeatedly asserted before the Court that the Lot's situation in the middle of the other lots acquired by the respondent gave it a particular strategic value, Mr Edward Chan SC, leading for the respondent, argued that the location of the Lot permitted viable redevelopment of the lots on either side, so that the "ransom power" attaching to the Lot was much less significant than it might otherwise have been. The Tribunal does not need to resolve conflicts of this nature since it does not have to decide on the value of the interest for itself.

36. The Tribunal was fully entitled to find that the majority owner's offer which exceeded both sides' assessment of the value of the appellant's proportionate share of the developable site, taking its redevelopment value into account, fell within the range of what was fair and reasonable. We are of

course not suggesting that it is necessary for the offer to "beat" the valuation as if it were a payment into court. What the Tribunal must do is to consider whether, in the circumstances of each case, the offer falls within a band of what represents a fair and reasonable assessment of the value of the minority owner's interest reflecting a proportionate share of the redevelopment value of the whole site. The Tribunal in the present case was entitled to find that the hurdle of s 4(2)(b) had been crossed and entitled to make the order for sale.

Power to order sale of all the lots

37. For the foregoing reasons the appeal was dismissed. We wish additionally to comment on one aspect of the case, not under appeal, which gives cause for some concern.

38. The Tribunal had, on the respondent's application, ordered the sale of the six lots intended for redevelopment in a single batch. However, the Court of Appeal held (§§12-20) that on the true construction of the Ordinance this was impermissible. It varied the Tribunal's order to confine it to an order solely for sale of the Lot. The order as varied is not under challenge and stands as between the parties.

39. There is, however, a danger that if the power is so confined the policy objectives of the Ordinance may be undermined. As the Court of Appeal recognized (§17), the minority owner, if sufficiently funded, might be able to bid up the single lot to a highly inflated price thereby exercising "ransom power" through the medium of the public auction. And if the minority owner or a third party actually acquired the auctioned lot, the intended redevelopment might have to be abandoned or face lengthy delays subject to the uncertainties of negotiations with the new owner of the lot. Such consequences plainly run counter to the statutory objectives.

40. If, on the other hand, it were open to the majority owner to combine sale of the Lot with sale of the other lots already owned, the entire developable site would be put up for sale. Such an auction could be expected to attract only bids from genuine developers. There would be no room for ransom-motivated bids. An appropriate reserve price would have to be fixed to ensure that the minority owner receives a proper share of the redevelopment value of the site. But whether the successful bidder should prove to be the majority owner or someone else, a redevelopment of the entire site would be able to proceed without impediment, in line with the objectives of the Ordinance.

41. Plainly, the power coercively to order sale is confined to ordering the sale of a lot or lots in which a majority owner and a minority owner each hold a proprietary interest. However, in cases where a majority owner qualifies for the making of such a compulsory order and wishes to have that lot put up for auction together with adjacent redevelopment lots wholly owned by him, the question arises as to whether, on its true construction, the Ordinance precludes the Tribunal from making an order for sale in respect of the composite site. That matter was not in issue and was not argued before us. In the light of the policy concerns noted above, we wish expressly to leave that question open for possible future consideration.

42. Additionally, if a restrictive construction of the Ordinance is required, we wish expressly to leave it open for possible future consideration whether the Tribunal has a discretion to give suitable directions (under s 4(6)(a) of the Ordinance or otherwise) concerning conduct of the sale designed to secure that the sale of the single lot, the subject of its order, can take place together with the sale of the other redevelopment lots, similar to the directions given by the Court of Appeal in *Golden Bay Investment Ltd v Chou Hung* [1994] 2 HKC 197 at 200-202, or along analogous lines.

43. These issues raise difficult questions and the best course may be for them to be addressed by the legislature with a view to ensuring that the objectives of the Ordinance are not frustrated.

(Kemal Bokhary)
Permanent Judge

(Patrick Chan)
Permanent Judge

(R A V Ribeiro)
Permanent Judge

(G P Nazareth)
Non-Permanent Judge

(Lord Millett)
Non-Permanent Judge

Mr Benjamin Chain (instructed by Messrs William Sin & So) for the appellant

Mr Edward Chan SC and Mr C Y Li (instructed by Messrs So, Lung & Associates) for the respondent