

**For discussion
on 16 July 2014**

Legislative Council Panel on Development

Pilot Scheme for Arbitration on Land Premium

PURPOSE

This paper briefs Members on the implementation framework of the Pilot Scheme for Arbitration on Land Premium (Pilot Scheme).

BACKGROUND

2. Lease modification/land exchange, including premium negotiation, is a matter of contract between the Applicant and the Lands Department (LandsD). It can be concluded only with mutual agreement. The amount of premium payable for lease modification/land exchange is one of the key terms of any such contract. Accordingly, disagreement over the amount of premium payable by the Applicant could leave a lease modification/land exchange application unconcluded even after years of negotiation by both sides. The time taken to conclude the premium negotiation varies widely from case to case. Under the existing arrangement for premium negotiation, there are no limits on the number of appeals that an Applicant can lodge against premium offers made by LandsD. Any premium offer made by LandsD (for the first time or upon appeal) is normally valid for the Applicant's acceptance within one month. The Applicant may take into account its prevailing business considerations (such as those concerning market outlook, cash flow and capacity) in deciding whether or not to conclude the premium negotiation at a particular point in time. Neither party can compel the other to accept its position on the premium and, in practice, the disagreement could continue indefinitely.

3. Arbitration is a consensual dispute resolution process where the parties agree to submit their disputes to an arbitral tribunal for resolution, the award of which is final and binding. Arbitration is conducted in private and is generally confidential. The arbitration mechanism allows an independent and impartial third party to adjudicate the premium payable based on the arbitration terms and conditions agreeable to both sides. It could provide a means to resolve the disagreement between the two negotiating parties. The Pilot

Scheme will provide an additional avenue for both the Applicant and LandsD to expedite conclusion of land premium negotiations for lease modification/land exchange cases, which in turn would help speed up land supply for housing and other uses.

4. In his 2014 Policy Address, the Chief Executive announced the introduction of a Pilot Scheme to facilitate early agreement on land premium payable for lease modification/land exchange applications, with the objective of expediting land supply for housing and other uses.

TRIAL PERIOD OF THE PILOT SCHEME

5. As arbitration on land premium is uncharted waters in Hong Kong and public revenue is involved, we consider it prudent to start with a Pilot Scheme so that the Government can review the longer term arrangements in the light of experience. The Pilot Scheme will run for an initial period of two years starting from August 2014. The implementation of the Pilot Scheme will give the Government flexibility to fine-tune the arbitration mechanism and decide on whether and, if so, how it may continue and be applied on a broader scale after the Government has gained relevant experience.

IMPLEMENTATION FRAMEWORK OF THE PILOT SCHEME

(A) When Arbitration May Be Triggered

6. By virtue of Basic Law Article 7¹ which sets out the role of the Government as the custodian of the land resources in Hong Kong, the Director of Lands in the capacity of a private landlord must retain unfettered discretion in deciding whether or not to approve an application for lease modification/land exchange, including whether or not to resort to arbitration or any other mechanism as a means to resolve a dispute on the amount of premium payable. Without prejudice to such discretion, as a general guideline for the Pilot Scheme, either the Applicant or the Government may propose for the other party's agreement settling the premium negotiation by arbitration when both parties have failed to agree on a premium figure after substantial exchanges of views, normally after at least two appeals by the Applicant. This trigger point has

¹ Basic Law Article 7 reads "The land and natural resources within the Hong Kong Special Administrative Region shall be State property. The Government of the Hong Kong Special Administrative Region shall be responsible for their management, use and development and for their lease or grant to individuals, legal persons or organisations for use or development. The revenues derived therefrom shall be exclusively at the disposal of the government of the Region."

taken into account the fact that arbitration is a mutual dispute resolution mechanism which incurs cost. It would be premature to accept that there is an unresolved dispute before the parties engage in substantive discussions. LandsD's experience in premium negotiations is that issues of dispute will become crystallised only after a few serious appeals with exchange of further information.

(B) Case Prioritisation and Selection Criteria

7. If upon reaching the trigger point mentioned in paragraph 6 above, many Applicants express readiness to enter into arbitration and this overall demand exceeds the capacity of LandsD, the Department of Justice (DoJ) and the arbitrator-candidates in handling multiple arbitration cases at the same time, LandsD will adopt certain criteria in guiding the prioritisation of case work such as -

- (a) higher priority to "high yield" cases in terms of net increase in flat number (e.g. not less than 200) or net gain in non-residential GFA (e.g. not less than 20,000m²);
- (b) higher priority to cases with a wider premium gap; and
- (c) higher priority to cases with fewer issues in dispute or with relatively straightforward disputes.

(C) Scope of Arbitration

8. The subject to be arbitrated should be confined to the amount of premium. Where the Applicant refuses to accept a premium offer by virtue of his disagreement with the Government on matters of lease interpretation (e.g. how the "industrial" use permitted under the lease should be interpreted) and government policies (e.g. that the premium payable is the difference between the "before" and "after" value, that compensation offered and paid by the Applicant for affected residents cannot be premium-deductible), these fundamental issues with policy and sector-wide ramifications are not to be put before the Arbitral Tribunal for a ruling. If the Applicant wishes to challenge these fundamental issues, it should resort to the existing avenue of taking civil proceedings against the Government and the Government would defend in open court.

9. To ensure that the arbitration process will be focused and not become complicated or protracted by the parties and/or the arbitrators bringing in new issues during the process, the arbitrators will be provided with a Fact

Sheet and a List of Disputes for the case in question. Both documents will be annexed to and form part of the Arbitration Agreement. The Fact Sheet will set out the basic terms for the land exchange/lease modification case and any other relevant matters concerning lease interpretation, government policies, the Government's established valuation basis and other essential valuation components already agreed between the parties, and hence should not be subject to arbitration. The List of Disputes will set out specific issues (normally those relating to the valuation components used for arriving at the premium amount) which will be determined by the arbitrators during the arbitration process as they come to a decision on the premium amount. As the List of Disputes will be formulated according to the issues at dispute as agreed by the parties, we consider it reasonable to only allow adjustment of the List of Disputes by mutual agreement of the parties (for example, if this need becomes apparent arising from clarifications sought by the Arbitral Tribunal).

(D) Composition of the Arbitral Tribunal

Number of Arbitrators

10. To enhance impartiality and credibility, and avoid over domination by any individual, the Arbitral Tribunal will comprise three arbitrators. Indeed, a three-member tribunal is the international trend in arbitration in general. While one of the arbitrators will be the President or leader to ensure that the arbitral procedural steps will be scrupulously observed, all three arbitrators will carry the same weight in the Tribunal in deciding the arbitral award.

Qualification/Professional Background of Arbitrators

11. The President of the Tribunal will be a legal professional, who may be a retired judge, or a barrister or solicitor with at least 10 years of post-qualification experience. This is to enhance credibility, fairness and impartiality. The President of the Tribunal, with robust legal background, would be familiar with the relevant laws and could ensure that the procedural steps are scrupulously observed by the Tribunal. As regards the two other members of the Tribunal, they should be persons who can best understand the issues under dispute which specifically concern land premium in the context of Hong Kong. Therefore, they should be valuation professionals, specifically professional surveyors with at least 10 years of experience in land matters and valuation.

12. No arbitration qualification requirement will be prescribed for the President or members of the Tribunal. This has taken into account the fact that quite a considerable number of practising arbitrators, including those who are

experienced and reputable in the field, do not possess any arbitration qualification. If we prescribe such a requirement for the Pilot Scheme, we may unnecessarily limit the pool of potential candidates. That said, we may consider commissioning optional short courses on arbitration to familiarise potential arbitrators (particularly those from the surveying discipline) with the basic principles and proceedings of arbitration.

(E) Appointment Mechanism

13. The President of the Arbitral Tribunal will be nominated and agreed by the Government and the Applicant. Specifically, both parties may propose nomination(s) and agree by consensus. As regards the other two members, the Applicant and the Government (i.e. LandsD) will each nominate one valuation professional who would be subject to the other party's agreement.

14. We will resort to Hong Kong International Arbitration Centre (HKIAC) as the Appointing Authority in case of disagreement on appointment of arbitrators within a designated timeframe. This is based on the practice set out in the Arbitration Ordinance (Cap. 609)².

(F) Safeguarding against Conflict of Interest

15. Following international practice, the arbitrators will be required to make a written declaration (on a standard form) as to their independence and impartiality, and in so doing disclose any matters that might be relevant in this regard, and confirm their on-going duty of disclosure during the arbitration process. The arbitrators will also be required to declare that they have not solicited or accepted, and undertake that they will not so solicit or accept, any advantage as defined under the Prevention of Bribery Ordinance (POBO) (Cap. 201) in connection with that arbitration case in question. The signed declaration will make reference to relevant statutory provisions in the Arbitration Ordinance and to the International Bar Association Guidelines on Conflict of Interest in International Arbitration, which are guidelines generally adopted by the international arbitration industry as a standard on management of conflict of interest by arbitrators. Once signed by the appointed arbitrators and attached to the Arbitration Agreement signed between the Applicant for lease modification/land exchange and the Government, the arbitrators of the Tribunal will be made party to the Arbitration Agreement and subject to all

² Pursuant to section 24 (1) of the Arbitration Ordinance which gives effect to Article 11 of the United Nations Commission on International Trade Law (UNCITRAL) Model Law, if the Parties fail to agree on a procedure of appointing the arbitrators or the Parties are unable to reach an agreement under the agreed appointment procedure, any party may request HKIAC to make the appointment and the decision of HKIAC shall be subject to no appeal.

provisions therein as to the proper conduct of the proceedings. These written declarations would be kept confidential, having regard to the general feedback from stakeholder groups that such public disclosure would inhibit prospective arbitrators from accepting the appointment, hence compromising the chance of the parties concerned getting the best candidates to serve as arbitrators.

16. Anti-collusion provisions will also be included in the Arbitration Agreement such as those specifying no unauthorised discussion with the parties on the case and requiring the arbitrators to report any communication with the parties concerned outside the arbitral proceedings.

17. On whether the Government should introduce post-arbitration appointment control to guard against arbitrators taking up as “deferred benefit” future appointment(s) offered by the applicant-developer and/or the Government, all stakeholder groups consulted, including those from the legal sector, have advised against such a suggestion and cautioned that this, if introduced, would discourage arbitrators from taking part in the Pilot Scheme and is practically a non-starter. The fact is that such kind of post-arbitration appointment control is something unheard of in arbitration practice both locally and internationally, irrespective of the significance of the arbitration cases in question. Noting the international practice, we consider it impractical to deviate from the norm. It is also worth noting that arbitration has always been premised on a reasonable degree of trust in the professional conduct of those appointed as arbitrators regulated by their respective professional institutions.

(G) Measures to Guard against the Applicant “Walking Away” during the Arbitration Process or after the Arbitral Award

18. To ensure that arbitration would indeed lead to additional land supply, we will put in place measures that would deter the Applicant from “walking away” during the arbitration proceedings or after receiving the arbitral award. To this end, we will require the Applicant to pay the Government 15% of the premium last assessed by the Government if it backs out during the arbitration proceedings or fails to execute the lease modification/land exchange at the premium as arbitrated. Within this amount, we expect the payment of at least the first 10% as cash deposit upon the signing of the Arbitration Agreement, with the remaining 5% taking the form of a performance bond to be cashed only upon the Applicant defaulting. We see a case for requiring a deposit higher than the usual 10% required of the normal lease modification/land exchange cases where the premium is accepted without going into arbitration. Conceptually, a higher level of commitment is required under the Pilot Scheme bearing in mind the objective of disincentivising the Applicant from not executing the land document and implementing the development simply

because the arbitral award is not in its favour. To further reduce the risk of the Applicant shirking its responsibility under the Arbitration Agreement through other means, we will impose restrictions on alienation of the subject lot and on transfer of shareholding (in case the Applicant is a company) until execution of the lease modification/land exchange documents in accordance with the Arbitration Agreement.

(H) Date of Valuation and Arbitration Timeframe

19. As premium assessment takes into account the prevailing market situation, it is the Government's established practice to adopt the current date as the date of valuation, i.e., the most up-to-date market evidence (including transaction records) is gathered when a decision on land premium is made, and the decision would remain valid for acceptance for one month. As the arbitration proceedings would span at least a few months during which the market may have changed, it is possible that the premium figures proposed by the applicant-developer and the Government and put before the Arbitral Tribunal may no longer be current. On the other hand, the arbitration process will be complicated or prolonged if constant updating by either or both parties is allowed. Therefore, we will fix the valuation date to be the date when the Arbitral Tribunal is first constituted.

20. To avoid the land premium assessed as at this fixed date becoming too out of date, the Tribunal should be required to hand down its award within a specific timeframe. Noting our intention to complete the arbitration on each case within a span of a few months, some experts in the field have suggested that the Government may consider confining arbitration under the Pilot Scheme to "documents only" proceedings given the narrow focus (focusing only on premium) and the need for a timely decision on a market-sensitive premium figure. Others have, however, commented that such a restriction may inhibit the applicant-developers from coming forward. On balance, we intend to agree with the Applicant on a suitable timeframe on a case-by-case basis. As a general reference, we expect the Tribunal to hand down the award around 10 weeks after the constitution of the Tribunal for a relatively straightforward case suited to "documents only" proceedings (without any provision for hearings). The Tribunal will still have the right to seek oral clarifications from the parties as may be necessary during these "documents only" proceedings. An indicative flowchart is at Annex. If hearings are permitted, the specified timeframe will probably have to be extended by at least a few weeks. If, in the course of the proceedings, the Tribunal sees a need to deviate from the specified timeframe, it has to justify the case for agreement by the parties concerned and, depending on any extension agreed and its duration, the parties may also need to reserve their rights to make corresponding adjustment to the valuation date to

reflect the unforeseen extension.

(I) Arbitral Award

21. The Tribunal will determine the arbitral award having regard to all the evidence put before it, without being confined by any pre-determined upper and lower limits. It will be required to come up with an appropriate arbitral award by consensus or majority vote.

(J) Confidentiality

22. There are suggestions that publication of “reasoned arbitral awards”, i.e. disclosure of not just the award but also the reasons leading to that award, may enhance transparency and provide useful reference for premium discussions on other cases. On the other hand, almost all stakeholder groups consulted have advised that arbitration is by nature confidential, that arbitrators could not normally disclose anything related to an arbitration case, and that they will be *functus officio* (i.e. having discharged their duty) after the arbitral award has been handed down. Many also appreciate the need to protect commercially sensitive information which is often featured in discussions on lease modifications. It is also important to note that discussions on lease modifications/land exchanges, including the premium negotiation process, have always been private contractual matters between the Applicant and LandsD (acting in its private capacity as landlord). The arbitration procedure is essentially an extension and enhancement of the existing private contractual process; hence, the same level of confidentiality should apply.

23. On balance, we will follow the norm of keeping the arbitration proceedings confidential. The amount of premium charged on the basis of the arbitral award will nonetheless be disclosed through usual registration of the lease modification/land exchange document in the Land Registry. When agreeing to arbitration, we will also reserve our right to disclose for public information the cases put to arbitration and the arbitrators appointed, after the execution of the relevant lease modification/land exchange cases on the basis of the arbitral awards. We will, in the light of experience and with the benefit of reading actual arbitral reports submitted under the Pilot Scheme, review whether and, if so, how any considerations of useful general reference can be shared within the industry or made public.

(K) Arbitration Cost

24. Each party shall bear its own legal and other costs. The costs of the arbitral proceedings (other than each party’s own costs), including the fees

and expenses of the Tribunal (which shall cover the fees of appointing the three arbitrators), shall be borne by the parties in equal shares, unless, in its discretion, the Tribunal considers a different allocation appropriate.

(L) Challenge against Arbitral Award

25. The Arbitration Ordinance limits court interference in the arbitration of a dispute, and sets out an exhaustive list of instances in which a court can intervene in the arbitral process.³ An arbitral award made by a tribunal may be set aside by the Court of First Instance if the Court of First Instance upholds a challenge made against an arbitrator of the tribunal.⁴ Apart from that, the Court of First Instance may set aside an arbitral award on the grounds as set out in section 81(1) of the Arbitration Ordinance.⁵ In addition, the Arbitration Agreement will provide expressly for the application of sections 4 and 7 of Schedule 2 of the Arbitration Ordinance under which a party may apply to the Court of First Instance challenging an arbitral award on the ground of serious irregularity affecting the tribunal, the arbitral proceedings or the award.⁶

CONSULTATION

26. We have consulted relevant stakeholder groups on the above framework. They include the Hong Kong Institute of Surveyors, the Royal Institution of Chartered Surveyors, the Real Estate Developers Association of Hong Kong, Hong Kong Bar Association (some members on an ad personam basis), the Law Society of Hong Kong, HKIAC, Hong Kong Institute of Arbitrators and the Hong Kong Mediation and Arbitration Centre. We have also consulted the Lands Sub-committee of the Land and Development Advisory Committee. They generally support or express no objection to the above framework. Their specific comments have been incorporated into the

³ Section 12 of the Arbitration Ordinance gives effect to Article 5 of the UNCITRAL Model Law which provides that in the matters governed by this Law, no court shall intervene except where so provided in this Law.

⁴ Pursuant to section 25(2) of the Arbitration Ordinance, an arbitrator may be challenged if circumstances exist that give rise to justifiable doubts as to his impartiality or independence or if he does not possess qualifications agreed to by the parties.

⁵ Under section 81(1) of the Arbitration Ordinance, an arbitral award may be set aside only if (a) a party to the arbitration agreement was under some incapacity; (b) the arbitration agreement is not valid under the law; (c) the party was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case; (d) the award deals with a dispute not contemplated by or not falling within the terms of the submission to the arbitration, or contains decisions on matters beyond the scope of the submission to the arbitration; and (e) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties.

⁶ Section 99 of the Arbitration Ordinance provides that an arbitration agreement may provide expressly, among others, sections 4 and 7 of Schedule 2.

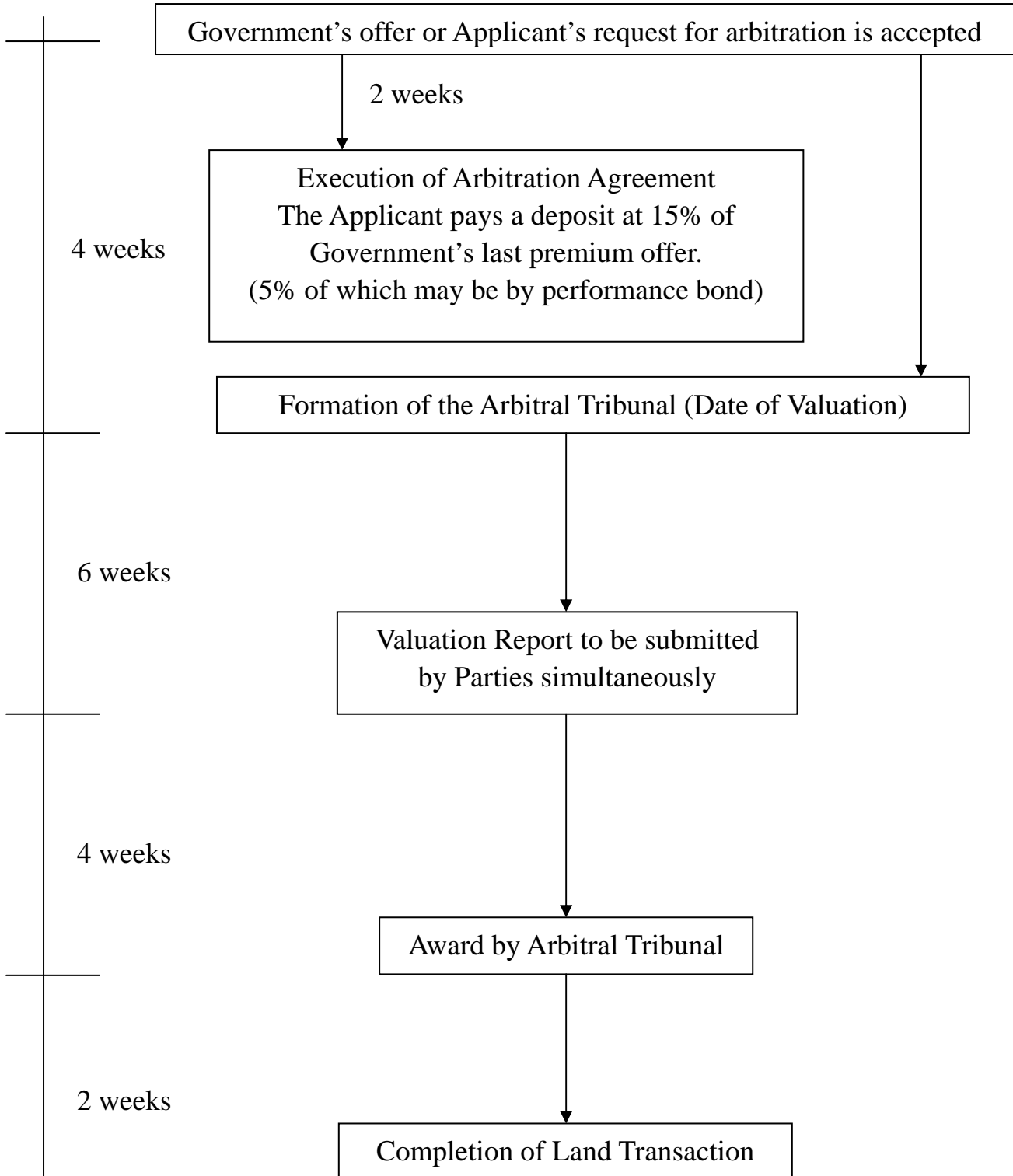
framework and reflected in the preceding paragraphs as appropriate.

ADVICE SOUGHT

27. Members are invited to note the implementation framework of the Pilot Scheme and provide views.

Development Bureau
July 2014

**Indicative Flowchart for Arbitration Procedure
(optimistic estimation for straightforward cases under “documents only”
procedure)**



Remarks:

From execution of arbitration agreement to arbitral award: 12 weeks

From formation of arbitral tribunal to arbitral award: 10 weeks