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Letterhead of LAW SOCIETY OF HONG KONG

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Direct Line : **BY FAX (25916002) AND BY POST**
4 May 2000

Mr. Francis Lo
Home Affairs Bureau
Government Secretariat Home Affairs Bureau
31/F., Southorn Centre,
130 Hennessy Road, Wanchai, Hong Kong.

Dear Mr. Lo,

Building Management (Amendment) Bill 2000

Further to my letter to you dated 26 January 2000, I am pleased to advise that the Working Party set up by the Society's Property Committee to review the proposals in the Building Management (Amendment) Bill 2000 has completed its task. I attach a copy of their submissions on the Bill for your further action.

The Society's submissions are wide ranging and touch on some fundamental aspects of the Building Management Ordinance ("BMO") which have not been canvassed in the Bill.

These legislative proposals only came to the Society's notice when the Bill was gazetted and the Society notes with regret that the Home Affairs Bureau did not see fit to seek the Society's views on fundamental issues at an earlier stage of the process. Many of our members have been enlisted to provide voluntary legal service to the public by giving advice on matters relating to building management in the Building Management Resources Centres which the Bureau has been coordinating and the role of members in this area of practice should be quite obvious to the Administration. The Society was never consulted on the proposed amendments to the BMO in the 1998 consultation exercise nor on the contents of the present Bill. The Bill was sent to our President for *"information and retention"* only.

There are serious *fundamental* problems with the BMO as well as the Bill that the Law Society is unable to support its passage.

Yours faithfully

Christine W. S. Chu
Assistant Director of Practitioners Affairs

c.c.: Mrs. Eleanor Chow, Clerk to Bills Committee (Fax No.28778024)

BUILDING MANAGEMENT (AMENDMENT) BILL 2000

The Law Society's Property Committee has set up a Working Party to review the proposed amendments to the *Building Management Ordinance* (the "BMO") via the *Building Management (Amendment) Bill 2000 (the "Bill").* Their comments are as follows:

A PURPOSE

1. The primary aims of the BMO, as suggested in the Ordinance itself. are to *"facilitate"* the incorporation of owners of flats and to provide for the management of buildings or groups of buildings.

2. The Bill serves to further those aims, inter alia, by:
   (a) specifying the building management and maintenance standards for compliance by owners' corporations ("OCs");
   (b) imposing mandatory management requirement for buildings with serious management and maintenance problems; and
   (c) facilitating owners of <u>new</u> buildings to form OCs.

3. While the Bill is a laudable move in the right direction, it stops short of recognizing and dealing with the more fundamental problems in the BMO. These include:
   (a) the existing mechanism provided in the BMO for formation of management committees ("MCs") and OCs is not available to buildings or groups of buildings where there is no allocation of undivided share;
   (b) the different criteria adopted to calculate the percentage of owners or owners' interest necessary to convene meetings of the OCs, to constitute sufficient quorum and votes to pass resolutions at such meetings may cause confusion to the property owners and their advisers;
   (c) a cumbersome procedure is laid down for appointment of MCs after application to the Secretary for Home Affairs ("SHA") under section 3A;
   (d) it is not always clear whether a proxy holder will be counted for the purpose of establishing a quorum in a meeting;
   (e) there is no direct means for owners to convene meetings of the OCs;
   (f) the extent to which OCs can exercise and enforce the rights and liabilities of the owners in relation to the building prior to its incorporation under section 16 is unclear; and
   (g) it is unclear whether the Lands Tribunal has exclusive jurisdiction under section 45 to determine any proceedings specified in the Tenth Schedule.

4. As it is preferable for some of these problems to be resolved ahead of or at least simultaneously with the implementation of the various proposals under the Bill, this paper will first elaborate on the aforesaid problems in the BMO before going into detailed examination of the various proposed amendments in the Bill.

B. MAJOR DEFICIENCIES IN THE BMO

1. Deficiency of the mechanism provided under the BMO for owners to form OCs

1.1 To form an OC under the BMO, the owners have to first convene a meeting under sections 3, 3A or 4 to appoint an MC. However, it will be seen that the statutory procedure for the appointment of MCs and the formation of OCs will not be available to owners in buildings or groups of buildings where there has been no allocation of undivided shares.

1.2 The term *"owner"*, as defined in section 2, refers to

"(a) a person who for the time being appears from the records at the Land Registry to be the owner of ***an undivided share*** *in land on which there is a building; and*

(b) a registered mortgagee in possession of such share."

1.3 However, in a great number of low-density estates, owners of buildings or groups of buildings do *not* own any undivided shares in the whole of the estate and/or the land on which the estate is constructed. What they own are pieces of land, sometimes sections, but more often subsections of big pieces of land.

1.4 This is not an uncommon phenomenon. The two largest low density estates in Hong Kong, namely, HONG LOK YUEN and FAIRVIEW PARK, provide no undivided shares for owners. Each of the owners owns a piece of land with a house erected thereon.

1.5 As a result, these owners with no undivided shares are technically not *"owners"* within the ambit of the Ordinance and none of sections 3, 3A and /or 4 of the BMO may be resorted to.

1.6 Even if these owners can be regarded as *"owners"* under the BMO by a change of the definition of *"owners"*, they still cannot take advantage of the statutory procedures laid down for appointing MCs for reasons stated in the following paragraphs.

1.7 Under sections 3(1)(a) & (b) and 3(2)(a), except in cases where the person to convene the owners' meeting and/or the manner for the appointment of an MC is expressly provided in the deed of mutual covenant, reference is made to the number of *shares* held by each owner to determine if the requisite percentages to convene the meeting, to constitute the necessary quorum and/or to pass the necessary resolutions are met.

1.8 Section 5(5)(a) provides that *"At a meeting convened under sections 3, 3A or 4, each owner shall, save where the deed of mutual covenant otherwise provides, have one vote in respect of each share which he owns"*.

1.9 The share of an owner in a building is determined under section 39. In brief, save as otherwise provided in a DMC or other documents, such ***share*** is determined by reference to the proportion his ***undivided share*** in the building bears to the total number of shares into which the building is divided.

1.10 Accordingly, unless the particular DMC has provided for the manner to determine each owner's *"share"*, the number of votes each owner can exercise in an owners' meeting, the manner for *convening* an owners' meeting and/or the manner for the appointment of an MC in such meetings, these owners with no undivided shares cannot rely on the statutory provisions of sections 3, 3A and/or 4 of BMO to convene owners' meetings or to pass resolutions to appoint an MC.

1.11 ***It is recommended that:***

(a) the definition of "owner" under section 2(1) and the manner for determination of voting rights under section 5(5)(a) to be modified to provide for developments where no undivided share has been distributed to the owners; and

(b) corresponding amendments be made to paragraph 3(5) of the Third Schedule and the Eighth Schedule of the BMO as appropriate.

2. Criteria adopted for determining the percentages of owners or owners' interest necessary to convene owners' meetings or meetings of the OCs, to constitute quorum and pass resolutions at such meetings

2.1 The BMO and the proposed amendments under the Bill have adopted two different criteria in calculating the percentage of owners or owners' interest necessary to convene meetings of the OCs, to constitute sufficient quorum and votes to pass resolutions at such meetings. By way of illustration, for one single matter to be resolved at a meeting, owners have to refer to the number of owners (*"number criterion"*) to determine quorum and to the number of shares they hold (*"share criterion"*) to determine if there are sufficient votes to pass the relevant resolution.

2.2 ***Meetings of OCs - Third Schedule of BMO***

2.21 The meetings and procedures of OCs are, according to section 8(5), specified in the Third Schedule of BMO. While the *number criterion* is adopted to determine the percentage of owners for *convening* an OC's meeting and constituting a *quorum* of such meeting, the *share criterion* is adopted for determining the number of *votes* each owner have in the OCs' meeting.

2.22 The relevant clauses in the Third Schedule are:

(a) Clause 1(2): the chairman of the MC is obliged to *convene* a general meeting of the OC at the request of *not less than 5% of the owners;*

(b) Clause 3(3): Matters arising at a meeting of the OC at which a quorum is present shall be decided by a majority of votes of the owners.

(b) Clause 3(5)(a): at any meeting of the OC, each owner shall have *one vote in respect of each share he owns;*

(c) Clause 5: the *quorum* at a meeting of the OC shall generally be *10% of the owners* except in the case of a meeting at which a resolution for the dissolution of the MC under section 30 is proposed, then the quorum shall be *20% of the owners.*

2.23 In the case of *U Wai Investment Co. Ltd. & Anor*, v. *Au Kok Tai & Anor.* LT BM No. 80 of 1997, it was held that the literal meaning of the *"5% of the owners"* under Clause 1(2) of the Third Schedule referred to the *number* of owners and not the share they own in aggregate.

2.24 The entire procedure can thus result in very obscure situations. There can be cases where an owner (*"1st Owners"*) owns 90% of the undivided shares and the rest of the 10% of the undivided shares are held by 100 persons each owning 0.1% of the undivided shares. The total number of owners in the building is thus 101. In this situation, while the 1st Owner has sufficient votes to pass the necessary resolution at a meeting, he cannot request for a meeting to be convened nor satisfy the quorum requirement. The only way to go around this problem is to assign its shares to a number of different entities.

2.3 ***Owners' meeting - Eighth Schedule of BMO***

The procedures for owners' meeting laid down under the Eighth Schedule, which are to be statutorily implied under section 34F in a DMC, are tainted with similar problems. The quorum requirement of 10% of the owners under Clause 11 adopts the number criterion while the percentage to convene the meeting (i.e. 5% of the shares under Clause 8) and the manner to calculate voting (i.e. 1 vote in respect of each share under Clause 13) adopts the share criterion. The lst Owner in the aforesaid example will find that he can convene a meeting and pass the relevant resolution but cannot satisfy the quorum requirement.

2.4 ***Newly Proposed Section 3(3)***

2.41 The newly proposed section 3(3), which has to be read with section 3(1), likewise falls victim to this unnecessary complexity. Unless otherwise specified in a DMC, owners of not less than 5% of the shares are required under section 3(1)(c) to convene a meeting of the owners to appoint an MC. The quorum requirement under the newly proposed section 3(3) adopts the number criterion of 10% of the owners and the resolution will be passed by the majority votes of members at a meeting with sufficient quorum. Under section 5(5)(a), the number of votes of such members will be determined, unless the DMC otherwise specifies, by the number of undivided shares held by them.

2.42 There can be circumstances where 10% of the owners (under the number criteria) wishes to form an MC under the newly proposed section 3(3) but only to find that they are not qualified to convene a meeting under section 3(1)(c) which requires owners with not less than 5% of the shares. It is indeed anomalous for a meeting

not to be convened against the wishes of those owners who represent sufficient interest to constitute the necessary quorum and to pass the desired resolutions, The combined effect of section 3(1)(c) and section 3(3) creares a monster, which is neither fish nor fowl.

2.5 The confusion is aggravated by the fact that in so far as the number criterion is concerned, it is not at all clear whether co-owners are to be regarded as one owner or to be treated as separate ones.

2.6 ***It is recommended that one single criterion be adopted throughout the BMO to determine the percentage of owners' interest required to convene a meeting, to constitute a quorum and pass resolutions at such meeting.***

3. Cumbersome Procedure for Appointment of MCs after application to the SHA under section 3A

3.1 Section 3A gives the owners of not less than 30% of shares the right to apply to the SHA for an order to convene a meeting of the owners to appoint an MC. However, the effectiveness of the order made by the SHA is made subject to the rights of owners holding not less than the equal percentage of shares to raise objection provided that the notice of objection is received by the SHA not less than 7 days before the date of the meeting.

The Working Party cannot see the logic for including such an objection mechanism in the section 3A procedure when theoretically owners holding up to 70% shares (other than those objecting) may be agreeable to the order to convene a meeting and pass the resolution. The objection mechanism may also cause confusion especially in big developments when notices of the meeting have already been issued to all owners. Chances are that the notice of objection may be received by the SHA just 7 days before the meeting to be held leaving scant time for the convenor to issue notices to all owners of the cancellation of the meeting.

3.2 ***It is recommended that the objection mechanism provided in section 3A be removed altogether.***

4. Whether proxy holder is to be counted towards establishing a quorum at a meeting

4.1 It is not always clear under the BMO whether proxy holders are to be counted towards establishing a quorum. While the Bill has attempted to clarify the status of proxy holders in this regard in OCs' meetings by adding a new sub-clause 5(2) in the Third Schedule of BMO, it fails to make similar clarifications in the Eighth Schedule regarding owners' meetings.

4.2 ***It is recommended that unless there is good policy reason why proxy holder should not be counted for the purpose of establishing a quorum at some***

meetings, corresponding amendment as that proposed in the Third Schedule be made to the Eighth Schedule of the BMO.

5. Oppression of MC to other owners

5.1 The existing Third Schedule does not provide any direct means for owners to convene meetings of the OCs. Clause 1(2) of the Third Schedule only imposes upon the chairman of the MC a duty to convene a general meeting at the request of 5% of the owners. However, members of the Working Party are aware of instances when chairman of the MC persistently refused to convene meetings using groundless allegations. The only relief available to these owners in such circumstances is to issue proceedings against the chairman and/or the OC with onerous legal costs being incurred to the owners.

5.2 ***It is recommended that the Third Schedule should incorporate a clause giving owners holding a minimum percentage of shares a right to convene a general meeting of the OC.***

6. Extent to which OCs can exercise the rights and enforce the liabilities of the owners in relation to the building prior to its incorporation

6.1 Section 16 of the BMO provides that when the OC is formed, the rights, powers, privileges and duties as well as the liabilities of the owners in relation to the common parts of the building shall be exercised by and enforceable against the OC to the exclusion of the owners.

6.2 However, in the case of *Hang Yick Properties Management Ltd*. v *The Incorporated Owners of Winner Building* HCA No. 4089 of 1996, it was held that the *liabilities* for management fees incurred prior to the termination of the Plaintiff's appointment as a manager could not be enforceable against the OC in the absence of specific statutory provisions requiring an OC to assume responsibility for pre-existing debts of that nature.

6.3 While this case is presently on appeal, the law as it now stands would mean that any *liabilities* of the owners in relation to the common parts of the building prior to the incorporation of the OC cannot be enforceable against the OC.

6.4 Logically, it follows that section 16 of the BMO does not provide for any statutory assumption of the owners' assets by an OC at the time of incorporation. The OC also cannot rely on section 16 to assume any rights of action of the owners against any third party who has committed tort against the owners prior to its incorporation nor can it sue the Manager for negligence or breach of contract committed before its incorporation.

6.5 Unlike a limited company which at the date of incorporation needs to issue shares to obtain initial capital, an OC when incorporated has not gone through the

process of share issue, capital injection, assignment of rights, etc. Applying *Winner Building* case, the OC would have ***no right or liability*** at the date of incorporation. There is the question as to how the OC can take up the rights of the owners in respect of the common parts if no assignment has ever been made.

6.6 ***It is recommended that the legislative intention in this regard should be clarified.***

7. Jurisdiction of the Lands Tribunal under the BMO

7.1 Section 45 of the BMO provides that the Lands Tribunal shall have jurisdiction to hear and determine any proceedings specified in the Tenth Schedule of the BMO However, uncertainty arises as to whether the Court of First Instance has jurisdiction over these building management cases.

7.2 There are conflicting decisions in this regards. There are, on the one hand, the 2 cases of *Incorporated Owners of Yuen Sun Mansion* v. *Luk Ngai Ling Irene* [1991] 1 HKC 410 and *Ngan Chor Ying & Anor* v. *Year Trend Development Ltd. & Anor* [1995] 1 HKC 605 deciding to the effect that the Court of First Instance has jurisdiction. On the other hand, there are the cases of *Mass Transit Railway Corporation* v. *Lam Kai Fai & ors* HCA 1796 of 1994 and *Winbase Industrial Ltd. et al* v. *Mightyton Property Management Ltd. & Anor* HCA 10232 of 1994 stating that the Lands Tribunal has *exclusive* jurisdiction. This uncertainty has created practical problems for litigants.

7.3 ***It is recommended that if the legislative intention is to vest exclusive jurisdiction with the Lands Tribunal, section 45 of the BMO should be drafted with sufficient clarity using similar wordings as section 5 of the Small Claims Tribunal Ordinance (Cap. 338) and section 7 of the Lands Tribunal Ordinance (Cap. 25)***

C. THE BILL

The following are the Working Party's comments on the various proposed amendments in the Bill:

Clause 3

Clause 3 seeks to introduce a new subsection 3(3) to the BMO to further simplify the appointment of MC in respect of buildings of which the DMC is to be executed by the parties after the commencement of that subsection. The resolution to appoint an MC will be passed by a majority vote of the owners either present or by proxy at a meeting with a quorum of 10% of the owners.

As already examined in paragraphs B1 and B2 above, one shortcoming of this new mechanism is that it will not be available to buildings or groups of buildings

where no undivided shares are distributed to the owners. Moreover, the new subsection may come in handy, but will still be up against a technical problem mentioned in subparagraphs B2.41 to B2.42 (inclusive).

It is recommended that:

(a) to maintain uniformity, one criterion be adopted for determining the percentages of owners or owners' interest necessary to convene meetings, to constitute quorum and pass resolutions at such meetings;

(b) similar provisions should be made to provide for buildings without any allocation of undivided shares.

Clause 5

A new section 18(2A) is proposed requiring an OC in the performance of its duties and the exercise of its power to have regard to and be guided by the Codes of Practice issued from time to time by the SHA. It is however unclear what constitutes sufficient *"regard"* and *"guidance"* for the purpose of section 18(2A).

It is recommended that what constitute sufficient "regard" and "guidance" for the purpose of section 18(2A) should be defined clearly.

Clause 6

Clause 6 proposes an amendment to section 27 of the BMO to require the auditing of OC's accounts by qualified accountants only. Exemptions are being provided for an OC of a building with not more than 50 *"flats"*.

It is however unclear whether car parks are regarded as *"flats"* for the purpose of the exemption. The word *"flat"* is defined under section 2 as *"any premises in a building which are referred to in a deed of mutual covenant whether described therein as a flat or by any other name and whether used as a dwelling, shop, factory, office* ***or for any other purpose,*** *of which the owner, as between himself and owners or occupiers of other parts of the same building, is entitled to the exclusive possession"*.

Members of the Working Party held conflicting views as to whether car parks are premises used *"for any other purpose"* within the definition of section 2. The facts that the Administration has in paragraph 14 of the Legislative Council Brief on the Bill dealing with this proposed amendments refers to *"flats/units"* couples with the Chinese translation of *"flat"* under the section 2 definition as " " seems to suggest that car parks are excluded from such definition.

It is recommended whether car parks are regarded as *"flats"* for the purpose of the newly proposed section 27(1A) of the BMO should be made clear in the Bill.

Clause 7

Clause 7 of the Bill proposes to amend section 28 to impose a mandatory obligation upon the OCs to effect third party insurance in respect of the building including the common parts. The detailed requirements of the insurance policy (e.g. scope of coverage, minimum level of indemnity, qualifications of insurers) are to be provided in the form of a Regulation under the Bill. If an OC fails to comply with the mandatory insurance requirement, every member of the MC shall be guilty of an offence and shall be liable on criminal conviction to a maximum fine of $50,000.

The Working Party notes that the mandatory insurance requirement is introduced as a result of the *Sun Hing Building* case. However, the case is an exceptional one and the universal application of the mandatory insurance requirement upon all buildings with OCs may not be justified. While it may already be the existing practice of prudent MC to require contractors to effect third party insurance, this requirement will impose too onerous a burden upon owners of certain types of developments. As this mandatory insurance requirement raise a question of affordability of owners of buildings, it is preferably for the Regulations setting out the detailed requirements of the insurance policy to be considered alongside with this proposed requirement. At the end of the day, care has to be exercized to avoid the new section 28 from acting as a disincentive for owners, particularly those of new buildings with few number of owners, to form OCs.

The imposition of criminal sanctions upon members of the MC for breaches of the mandatory insurance requirement under the new section 28 is also objectionable as it will deter owners from volunteering themselves to be members of the MC.

It is recommended that:

(a) The Administration should identify cases where the imposition of the proposed mandatory insurance requirement is necessary and the requirement shall be limited to apply to those specified cases;

(b) consideration of the proposed mandatory insurance requirement should be postponed after the Regulations providing for the detailed requirements of the insurance policy to be mandatorily taken out are available; and

(c) individual member of the MC should not be made criminally liable for breaches of the proposed requirement.

Clause 11

Clause 11 introduces three new sections 40B, 40C & 40D to provide for mandatory appointment of building management agent ("BMA") in buildings with serious management and maintenance problems.

In cases of buildings where no MC has been or is likely to be appointed, section 40C gives power to the SHA or an authorized officer to apply to the Lands Tribunal for an order to convene a meeting of the owners to consider appointing an MC or BMA.

It is however observed that section 40C in its present fashion may not effectively achieve the stated purpose. section 40C does not impose any mandatory duty on the owners to appoint an MC or a BMA. Under section 40C(1), the Lands Tribunal may order a meeting of the owners to be convened by an owner named in the order to consider passing either a resolution to appoint an MC or to appoint a BMA. It does not require any of such resolutions to be passed in the meeting. While the deeming provision in section 40C(3)(b)(ii) enables the owner named in the order to appoint a BMA, there is no statutory obligation for him to do so.

Section 40D(2) gives power to the Lands Tribunal to specify in its order made under section 40C the term and conditions of office of a BMA to be appointed. Under section 40D(2), the Lands Tribunal has power, inter alia, to direct that a BMA be appointed for an "indefinite" period. The Working Party cannot see any justification for making such an order. An order for the BMA to be appointed indefinitely will not only deny the right of owners to have free choice regarding future appointment of MC and a manager but also work contrary to the principle of improvements through competition.

While the powers of a BMA appointed pursuant to an order of the Lands Tribunal under section 40C is specified in 40D, the role of a BMA appointed by an MC under section 40 vis-a-vis the common parts of the building is not clear. Under section 16 of BMO, the rights, powers, privileges and duties of the owners in relation to the common parts of the building shall be exercized and performed by the OC to the exclusion of the owners. The effect that an appointment of a BMA under section 40B has in cases where the MC has already appointed a manager is also doubtful.

Last but not least, there is the question of affordability of owners in the appointment of a BMA whose costs are still to be seen.

It is recommended that:-

(a) the provisions of section 40C be tightened up to enable the Tribunal to make an order to mandatorily require the appointment of either an MC or a BMA to manage the building;

(b) the words "for an indefinite period or" in section 40D(2) be deleted; and

(c) the powers and duties of a BMA appointed under section 40B vis-a-vis the common parts of the building as well as the effect of such appointment upon the contractual relationship with the existing manager of the building be clarified in the legislation.

The Property Committee
The Law Society of Hong Kong
6 April 2000