Comments of the Hong Kong Bar Association

Consultation on Updating the Compulsory Sale Regime under the Land (Compulsory Sale for Redevelopment) Ordinance

1. The Legislative Council (LC Paper No. CB(1) 776/2022(05) made 4 proposals:

   (a) lowering threshold (%)

   (b) more flexibility regarding adjoining lots

   (c) streamlining process

   (d) enhancing support to minorities ("the Proposals").

2. (b), (c) and (d) are hardly controversial. The Bar will only comment on what should be done about adjoining lots, whether or not they form part of an application.

3. The Bar is of the opinion that for reasons we set out below, the proposals may not give sufficient protection to the minorities.

4. Whether the threshold should be lowered, and if so, to what % is more a political/social issue rather than a legal one.

5. That said, the proposal to lower the "baseline %" to 60% does appear to the Bar to be very low and close to a bare minimum.

6. The Bar would add that the lowering of the % not only affects "more" minority owners (see paragraph 33 of L C Paper). There are various social issues at stake, including the fact that pending an application being made and during its pendency, the units the applicant held are (usually) left in a state of dilapidation (and given the applicant's %

naturally also affects the whole building), not to mention the complaints about the steps taken to force the remaining minorities to sell.

7. The Bar reiterate the lowering of the % is not really a legal issue, and we therefore do not comment on the individual proposals. Annex VI set out 2 different calculations but it is unclear to us which one is preferred/proposed.

8. It may be helpful to say a few words about how applications under the Ordinance were supposed to be made, how they were as a matter of reality made, and why and on what basis applications were litigated before the Lands Tribunal.

9. On one view, the original idea behind the legislation was that individual owners of old buildings would come together and "pool" their individual units/undivided shares together and put the whole lot up for sale in the market, the rationale being a lot would allow redevelopment and would therefore fetch a better price than the aggregate of all individual units sold separately.

10. It was an alternative to partition. It also overrides any provision in some (especially modern) DMCs prohibiting partition.

11. In addition, it allows the requisite majority owners (90/80%) to apply, and it also made provision on the division of sale proceeds by (essentially) value instead of by undivided shares, which might be thought to be more equitable for multi storey buildings.

12. On the basis that there would be a sale by individual owners, it was also thought a public auction would fetch the best price, and hence a sale by public auction was made mandatory (s.5(1)(a)). The Tribunal was given no alternative.

13. It is to be noted that the Tribunal does have a discretion where all parties agreed, but that is an empty gesture since in practice, as will be explained below, no applicant will ever agree.

14. That is because as a matter of reality, almost all applications[1] under the Ordinance today are made by a developer (and/or its associates) who, having accumulated the requisite % in an old building, then made an application under the Ordinance to acquire the remaining units.

15. This is recognized by the Court of Appeal, and probably one of the reasons why the Court of Appeal held, as a matter of principle, the majority applicant should pay the costs of the minority.

16. The Ordinance is now, predominantly, being used for the purpose of compulsory purchase. The Ordinance therefore does not provide for compensation to be paid by the applicant, and it was assumed that the sale price will be the market price. The minorities, like the applicant majority, are expected to receive a true and fair share of the (market) value of the property.

17. There is never any suggestion, and none can really be justified, that the minorities when forced to sell their properties should not receive a true and fair share of the full value of their properties.

18. That afterall is provided for in Article 6 of the Basic Law.

[1] We cannot say there are no application made by majority owners but they are extremely rare. The reason seems to us to be when there are such large number of individuals, the owners usually would not be able to reach agreement on their respective "share".

19. The Ordinance therefore makes little provision to "protect" the minorities (except a minimum reserve price referred to below). Due to the way the Ordinance is now being used, the protection of the minority rights are inadequate. It is unclear from the L C Paper whether the government realized and/or accepted that (see, e.g. paragraph 31 of L C Paper) even though the L C Paper talked about "enhancing support (but not protection) for minority owners".

20. The way the Ordinance was structured does not really ensure the minorities will receive a true and fair share of the full value of their properties. In the Bar's opinion this is something any proposed amendments to the Ordinance should try to remedy.

21. As pointed out above, the Ordinance is now in reality a means used by developers for compulsory purchase, and instead of still proceeding on the belief that the market will take care of the "sale" price. The Bar submits it is time the government/legislative council to consider providing adequate means to safeguard the minority interests.

22. The way the Ordinance has now been used has 2 consequences:-

    (a) an Order for sale under the Ordinance is no longer really a sale by all the owners, but in reality a compulsory purchase order for the applicant developer; and therefore as a result,

    (b) the applicant developer naturally wants to pay as low a price as possible for the remaining units; instead of the situation where all the owners (both majority and minority) are putting up their properties for sale, in which case all will want to have as high a price as possible.

23. Absent an overhaul of the Ordinance, there is little to be done about (a), but the "problem" created by (b) can, and should be remedied as far as possible.

24. The "problem" of (b) lies in the following aspects in the way the Ordinance was enacted :-

(a) the (almost infamous) mandatory public auction,

(b) the setting of only a reserve price by the Tribunal, and

(c) a possible limitation on how the Tribunal can go about setting the reserve price.

25. By reason of the fact an applicant for an Order for sale under the Ordinance is almost inevitably a developer, instead of the applicant majority wishing to sell their properties, an applicant developer is only interested in buying the remaining units from the minorities, and will, again almost without exception, be bidding at the auction.

26. In such circumstances, by virtue of its majority holding (80% or 90%), the public auction simply does not provide a level playing field for other interested parties. The majority owner developer will nearly always enjoy a significant advantage over most (or all) other bidders in that the additional capital it needs to deploy will be much smaller. Again as a matter of reality, there is usually though not inevitably, no other bidder[2] at the auction, and what happened is that the applicant developer will buy the lot at the reserve price[3].

27. There is therefore a very strong case that the Ordinance should be amended to do away the mandatory public auction, which requires a fairly easy and simple amendment.

28. It does not matter whether any particular alternative is to be provided, a simple solution is to give the Tribunal a discretion to decide the mode of sale in any given case, depending maybe on the evidence and/or the market sentiment.

---

[2] There is also the possibility that among majority developers, there is some sort of consensus that they will not bid against each other when one is an applicant.

[3] Strictly speaking the majority owner is only buying (and paying) the remaining % :- see s.6.

29. Take e.g. the recent trend is that for most government land, the sale is by tender.[4]

30. Given an applicant developer will have already spent time and effort and money to accumulate up to the requisite %, a sale by tender has indeed an additional advantage in that the applicant is likely to play safe and on tender, to offer just a bit more as sort of an insurance to prevent its efforts being "stolen".

31. The public auction point is only one aspect, but an important one, of the problem. It is also one which is easy to tackle and remedy.

32. It seems to us clear that when the Ordinance requires the Tribunal when making an Order for sale only to set a reserve price, that was meant to be a minimum, when it was (perhaps wrongly) believed that the sale price would be determined by market force.

33. But as it turns out, anecdotal evidence suggests that the reserve price is, in the vast majority of cases, the eventual sale price.

34. One of the most controversial matters when an Order for compulsory sale was made, which formed the minority owners' main complaint, was that their properties were taken away from them without adequate compensation from, in reality, large developers.

35. As a matter of fact, in the great majority of cases which were litigated before the Tribunal, usually the one, and only, battle line is the reserve price[5].

36. The present "practice" of the Tribunal on setting the reserve price is to, in effect, adjudicate and determine what is known as the redevelopment value ("RDV") of the lot

[4] A government tender can be withdrawn, not that when the Tribunal made an Order for sale, see paragraph 65 below.

[5] There are cases that issues were taken on age/state of repair, but those were few and far between.

based on the evidence of the 2 expert valuers engaged by the Applicant and the Respondent.

37. It is to be noted that the term RDV does not even appear in the Ordinance, and is a term coined by valuers.

38. What the valuers (almost invariably) do is to propose an optimal redevelopment model[6] for the lot, and then to value each and every unit by comparables (with adjustments which can only be subjective); and then to use the residual valuation method to arrive at a (almost precise) figure of the lot's RDV.

39. In practice, it is again almost inevitable that the applicant's valuer will strive to arrive at as low a figure, and the respondent's valuer to arrive at as high a figure, as possible.

40. The Tribunal will then adjudicate on their differences and arrive at a figure which will become the reserve price, and in practice almost invariably the sale price.

41. At this juncture it is worthwhile to point out :-

    (a) the so-called optimal model for redevelopment (either those prepared by the valuers, or the one chosen by the Tribunal) is not binding on the purchaser and, given the theoretical nature of valuation, and that it is "more an art than science", in many cases that supposed optimal model does not represent what was eventually constructed on the lot,

    (b) by reason of the methodology referred to in paragraph 38 above, the figures are at least potentially inaccurate, if not unreliable, due to the many variables/uncertainties, and

[6] The model was prepared by a valuer, and not an authorized person.

(c) most importantly, the figure is only the "correct' figure at the date of judgment, whereas the sale/auction is at a later date, and the redevelopment completed and marketed even later.

42. Given the reserve price will usually become the sale price, another controversial provision in the existing Ordinance is paragraph 2(a) of Schedule 2, which provides that on an Order for sale, the lot shall be sold "subject to a reserve price which took into account the redevelopment potential of the lot on its own...".

43. This provision is at the centre of how the question about combination of adjoining lots should be approached.

44. The 1st controversy is whether that was inclusionary only, or exhaustive, the Chinese term is "顧及" ?

45. The phrase "on its own" was introduced at the Bills Committee stage. The minutes suggested it was thought "it would be difficult to assess the reserve price if other factors such as the potential of adjacent sites.....were taken into account."

46. It therefore appears the phrase was indeed introduced to exclude other consideration; on the other hand it has to be borne in mind that it relates only to the setting of the reserve price, which in 1998 might not have been apparent that it would (as is now in reality) almost inevitably become the sale price.

47. Due to that fact (i.e. the reserve price is usually the sale price), the "on its own" provision is now being exploited by applicant developer to limit the price payable, and it is likely unjustified[7], this is something which ought to be addressed and remedied.

48. We are therefore of the opinion whatever "difficulty" is no warrant to deprive the minorities of a fair share of the true value of their properties, and the words "on its own" in paragraph 2(a) of Schedule 2 should be removed.

49. That leaves the term "redevelopment potential" which is a related topic on how the Ordinance should deal with the issue of adjoining lots.

50. At present whether an application consists of more than one lot is a matter for the applicant on which the Bar have no strong view.

51. Given the basic idea of the Ordinance is to facilitate private redevelopment, the Bar believe the scale and nature should be left to the market, so long as the minority interests are well and truly protected.

52. The Bar agree with the proposal in paragraph 13 of the LC Paper to allow "more flexibility" for multiple adjoining lots, in particular the specific point that the present Ordnance allows averaging "only if the buildings.....are connected....by a common staircase".

53. Irrespective of whether the existing provision is deliberate or an oversight, the Bar see no reason why once a building is connected by a common staircase, that building should not be treated as a "lot" on its own for the purpose of its neighbouring lots.

[7] It is unjustified because redevelopment potential/potentialities is always part of the intrinsic value of a piece of land; the reserve price was meant to be a minimum protection and market force will be at work at the public auction, but for reasons stated above that is illusory.

54. Here the solution is again simple, just define "lot" to include a building connected by a common staircase.

55. Other than that specific point, while we are in principle agreeable to the idea to allow more flexibility, the Bar remain of the view that how the redevelopment should be carried out should be left to the market/individual developer, and there is no need to implement paragraph 21 of the LC Paper to compel all the lots to be redeveloped together after the sale.

56. On the other proposal of allowing wholly owned lot to be joined, the Bar do have reservation given the "problem" identified in paragraph 26 above. To allow an applicant to in effect, swamp the auction only exacerbates the problem[8].

57. On the proposal to apply "weighted average" (paragraph 19 of L C Paper and Annex VI), it is unclear whether the baseline % is still 60%, and it is also unclear what is the relationship, if any between the overall ownership % and the overall applicant threshold, both of which matters have not been set out in the body of the L C Paper.

58. The Bar agree with the proposals to streamline applications including those when there is no dispute on "age" and "state of repair".

59. The Bar also agree that there is now a huge burden on judicial resources when the battle line in many applications is one between 2 valuers (paragraphs 36 and 38 above) on matters of adjustments which are mostly subjective or judgmental.

[8] It may be argued that to prevent an applicant from joining wholly owned adjoining lot may subject it to "ransom" (see Annex IV). The answer to that is that the applicant is almost certainly a developer who are well placed to protect itself. In any event, albeit the CFA has held that under the Ordinance, there should be no "last unit premium", that is in practice more apparent than real, there is always a last unit premium for the "last" unit required to reach the requisite %.

60. The Bar believe at least one of the reasons why that is so is the requirement for an applicant to engage a valuer to prepare a statutory report when making an application :- s.3(1)(a).

61. The statutory report in fact has nothing to do with either the RDV, or the reserve price. Its function is to set the respective share (%) of each unit, which while not always agreed among all parties is in practice not something usually hotly disputed.

62. The Bar do however realize the use of experts is a subject which requires careful consideration given its impact on the profession.

63. There is also the fact that given the nature of the proceedings and the parties involved, there is already a risk that the minorities already suffered a real disadvantage through disparity of arms, and if their wish to engage their own expert is to be further watered down, that may be problematic both in practice and in perception.

64. The Bar have no doubt the Tribunal, especially its members are well aware of that and are trying their best to protect the minority interests, but given the way the Ordinance was structured, and the nature of our adversarial system, there is always a limit on what the Tribunal can do.

65. The fact that the Ordinance/the scheme thereunder is in truth a compulsory purchase has another consequence :- its progress is largely in the hand of an applicant developer (and in the worst case scenario, they can abandon it, or simply not proceed with the purchase at the auction if the market is against them), but for the minority there is no choice[9], and in this regard to draw attention to the recent comments from the government's sale of the Sai Yee Street site.

[9] This is again an unintended consequence. Had it been a real sale by all the owners, they would all want the best price, but in real life an applicant developer wants to purchase (the remaining units) at the lowest possible price.

66. The Bar therefore also suggest that it be made clear that the Tribunal should consider all the circumstances and be given a discretion not to make an Order even if the applicant can satisfy all the statutory criteria.

Hong Kong Bar Association
Dated: 21 March 2023