



SUBMISSIONS BY THE PROPERTY COMMITTEE OF THE LAW SOCIETY OF HONG KONG ON THE REPORT ON *LOCAL COMPLETED RESIDENTIAL PROPERTIES: SALES DESCRIPTIONS AND PRE-CONTRACTUAL MATTERS* ISSUED BY THE DESCRIPTION OF FLATS ON SALE SUB-COMMITTEE OF THE LAW REFORM COMMISSION

The Property Committee ("*the Committee*") of The Law Society of Hong Kong has reviewed the various recommendations put forward by the Description of Flats on Sale Sub-Committee ("*the Sub-Committee*") of the Law Reform Commission in its Report on *Local Completed Residential Properties: Sale Descriptions and Pre-contractual Matters*. Whilst that these recommendations follow closely what the Sub-Committee has previously proposed in its January 2001 Consultation Paper, the Committee notes with regret that many of its submissions made during the consultation stage have not been adopted. The Committee will accordingly reiterate its previous submissions on the various proposals as follows:

A. SECOND HAND MARKET (PART I)

1. Necessity for Regulations over the Second-Hand Market (Chapter 1)

1.1 The Committee generally supports and agrees with the idea that there should be a transparent and fair market in which the purchasers are provided with sufficient property information allowing them to make an informed choice. However, members take the views that it is in the first-hand and not the second-hand market that purchasers need more protection.

1.2 The purchasers in the first-hand market are obviously of unequal bargaining power

compared with the vendor developers and they are usually only able to view the show or mock-up flats. Purchasers in the second-hand market are, on the contrary, on equal footing with the individual vendors. Whilst the Subcommittee's view in paragraph 2.27 of the Report is noted, the Committee remains of the view that purchasers can inspect the properties before entering into the preliminary agreements for sale and purchase. This is particularly true when there is presently a buyer market and purchasers will simply not proceed with the purchase should the opportunity for inspection be denied.

Misrepresentation (paragraphs 1.4-1.6)

- 1.3 The Committee does not agree that the present law fails to provide sufficient positive protection for the purchasers in the second-hand market as is suggested in the Report. It is not as difficult as described for the purchasers to rely on the law of misrepresentation. To succeed in an action for misrepresentation, representation need not be the sole inducement and the test is subjective. If the purchaser has investigated and verified the representation, he is then not relying on the representation but enters into the agreement with his eyes open and there will be no inducement. However, the purchaser is generally under no duty to investigate unless the circumstances are so suspicious that he is put on notice. One may argue that the formal sale and purchase agreement frequently contains a standard clause to the effect that the agreement contains the whole agreement between the parties and that no representations or warranties other than those in the contract have been made or can be relied upon. However, the parties can always negotiate the terms of the contract and the purchaser can even insist upon insertion into the preliminary or formal agreement warranties or undertakings by the vendor of the accuracy of certain information
- 1.4 In this connection, *the Committee takes the view that the various recommendations in the Report regarding the secondary market may violate the principle of freedom of contract and run the risk of over-regulating the second-hand market, stimulating expensive litigation and creating uncertainty in the property market. A balance needs to be struck so that the vendor's rights will not be compromised.* Under the current conveyancing practice, there are many transactional issues that can neither be legislated nor be covered by legislation. Instead of imposing legislation to assist purchasers in every step of a property deal, public education may probably be a more effective way to protect purchasers.

2. Recommendation 2 - The Vendor's Information Form ("VIF") (Chapter 2)

- 2.1 The introduction of VIF in whatever form and manner may assist purchasers in

making more informed decisions but *the Committee is not in favour of such a recommendation.*

- 2.2 Whilst the recommendation may look good on paper, in reality, it will certainly increase the transaction time and costs. Most vendors will not be in a position to complete such a form particularly for old buildings or village type houses. If such is the case, professional help would be required.
- 2.3 The Sub-Committee has suggested in paragraph 2.18 that a VIF, which will assist a purchaser in making a more informed choice, will reduce the number of disputed sales. However, it remains to be seen whether the number of disputed sales can actually be reduced. With positive obligation of disclosure imposed on him, a vendor

has to ensure the accuracy of the property particulars. Failure to do so may amount to representation resulting in litigation. The purchaser may be more likely to initiate an action for misrepresentation against the vendor by relying on misstatement or even omission by the vendor to disclose information in the VIF. In a falling market, the contents of VIF will be manipulated as the means to call off transactions.

- 2.4 The Sub-Committee has quoted the practices and laws from certain jurisdictions. However, it is not clear about the practices in cities such as London, New York, Tokyo and Paris where real properties rank as the most expensive around the world. Purchasers of residential properties in these cities are in similar position to those in Hong Kong and it will be relevant to know what sort of protection has been offered by the relevant governments. Whilst the Committee has suggested in its last submission that any useful analogy and example to be drawn and followed should be with regard to the laws applicable to these cities, it is noted with regret that the Sub-Committee has not provided any information on the law of these comparable jurisdictions in the Report.

3. Recommendations 4 & 5 - Standard Clauses of Preliminary Agreements - Chapter 3

Cooling-off period (paragraphs 3.7–3.16)

- 3.1 The Sub-Committee has recommended (Recommendation 4):
- (a) for the preliminary sale and purchase agreement ("PSPA") for the purchase of second-hand completed flats to contain a standard clause giving the vendor and the purchaser (but not the vendor) a cooling-off period of three working days;
 - (b) in exercising the right to rescind the PSPA during the cooling-off period, the party electing to rescind is liable to forfeit to the other party an amount equal to five percent of the purchase price or the preliminary deposit whichever is the lower; and

(c) the parties should not have the right to sub-sell during the cooling off period.

3.2 The Committee does not think that this will bring about any drastic changes to the present situation. There is already in place a market practice which allows both the vendor and the purchaser a period during which either side may withdraw subject to limited loss, which is usually 5% of the purchaser price. Under the current market practice, a PSPA usually provides the following:-

- (i) payment of the initial deposit (usually less than 5%) but subject to negotiation;
- (ii) the vendor and purchaser shall sign a formal Agreement for Sale and Purchaser within 14 days from the date of the PSPA;
- (iii) should the purchaser fail to complete the purchase in the manner contained in

the PSPA, the deposit shall be forfeited to the vendor and the vendor shall then be entitled at his/her absolute discretion to sell the property to anyone he/she thinks fit and the vendor shall not sue the purchaser for any liabilities and/or damages or to enforce specific performance;

- (iv) should the vendor after receiving the initial deposit paid hereunder fail to complete the sale in the manner herein contained, the vendor shall immediately compensate the purchaser with a refund of the initial deposit together with a sum equivalent to the amount of the initial deposit as liquidated damages and the purchaser shall not take any further action to claim for damages or to enforce specific performances.

This is effectively a cooling-off period, which is available to both parties.

3.3 If the proposed cooling-off period is to set a minimum protection standard for purchasers, then the only practical effect it will have is where:

- (a) no estate agent is involved so that the usual form of PSPA containing the withdrawal clause noted above is not used;
- (b) where a purchaser would otherwise agree to enter into an immediate fully binding contract to purchase.

3.4 As far as the Committee is aware, there are few transactions not effected through estate agents. Therefore, the proposed cooling-off period would operate in most cases to interfere with parties' freedom to contract. While a vendor may forfeit a 5% or smaller initial deposit, the vendor may have given up other opportunities to dispose of his property by committing to sell to a particular purchaser.

3.5 ***The Committee holds the view that the proposed 3-day mandatory cooling-off period should not be introduced.*** Instead, the present practice with cooling-off provisions contained in the PSPA should be maintained. While we are now in a different market, it was not so long ago that speculation was rife and the market was volatile. It was then that vendors needed protection against unscrupulous speculators and only equitable that vendors should be allowed to bind a purchaser sufficiently in return for their commitment to sell and forego other opportunities. Under the present practice,

the principle of freedom of contract is maintained to the full. A mandatory cooling-off period should not be encouraged. It will only add uncertainty to a transaction and destroy the contractual terms already agreed between the parties.

B. FIRST-HAND MARKET (PART II)

1. **Recommendations 6 to 10 - The Provision of Sales Brochures (paragraphs 4.5-4.18)**

1.1 The Sub-Committee recommends that:

- (a) for “left-over flats (i.e. flats which were first marketed when uncompleted but are left unsold after issue of the occupation permit) the developer should make available the latest sales brochures and a VIF. However, up-to-date sales brochures should always be made available for completed flats marketed for the first time after the issue of the occupation permit;
- (b) sales brochures (and the VIF, where applicable) must be available by the developers from the time the completed properties are offered for sale;
- (c) all information in sales brochures (and the VIF, where applicable) must be accurate at the time the completed properties are first offered for sale;
- (d) if there are any material changes in the information in the sales brochure between the date of its printing and the time of sale, a note to that effect should be attached to the sales brochure or the price list; and
- (e) the developer may apply to the relevant authorities in certain circumstances for exemption from the requirement to produce a sales brochure.

1.2 The proposed sales brochure is an informative, accurate and technical sale literature amounting virtually to an encyclopedia of the property to be sold. It requires the assistance of a number of professionals such as architects, surveys, lawyers, project managers and artists involving substantial costs, resources and a considerable amount of time to compile.

1.3 While it may be worthwhile for developers of big projects each involving a few hundred units developed by phases to produce such sales brochures, it will cause great

hardship for developers of projects consisting of only a few units each particularly those small house owners in the New Territories (who are also within the definition of “developer”) with only three units to sell.

- 1.4 To balance the interests of the developer and the purchaser, *the Committee proposes that the requirement for production of sales brochures should not apply to those projects with individual units available for physical inspection and ready for immediate vacant possession and delivery and such requirement should be limited to those projects with completed units to be sold by mock-up or sample flats:*
- (a) the purchaser will be protected as, like purchasing property in the second-hand market, he can have actual physical inspection of the property; and
 - (b) developers, on the other hand, can have the flexibility:
 - (i) in a falling market, to choose to wait and sell their project until all units are available for physical inspection and ready for vacant possession and delivery without the production of the sales brochure thus saving costs and expenses and perhaps also avoiding any possible manipulation by the purchaser of the contents of sales brochures as a way to back out of the transaction; and
 - (ii) in a rising market, to sell the units earlier by sample flats to fetch a higher price by complying with the sales brochure requirement.

2. Recommendations 11 to 39 - Disclosure Requirements for Completed Units Offered for Sale by Developers (Chapters 5 & 6)

- 2.1 "Completed units" in the first-hand market are generally defined in the Report as those uncompleted units which have become "completed" with the issue of the OP. The Sub-Committee has suggested in the Report that as these completed units are offered for sale by developers in much the same way as if they were still uncompleted, all those recommendations which they have previously made in an earlier Report regarding ways to improve the quality of sales particulars and other matters relating to "local uncompleted flats" should also be extended to apply to these "local completed flats in the first-hand market".
- 2.2 The Committee understands that the Administration has issued a Consultation Paper

on the draft *Sales Descriptions on Uncompleted Residential Properties Bill* in April 2000¹ to which the Committee has sent its comments. It is observed that the majority of the recommendations focus on the contents of the sales brochures. Bearing in mind that similar recommendations were made in that draft Bill as those made under the present Report for completed residential units in the first-hand market and with a view both to ensure consistency in approach and to avoid duplication of efforts, the Committee trusts that it is premature to consider the various recommendations regarding sales brochures put forward in this Report until the draft Bill nears its completion stage. In this regard, *the Committee would like to reserve its comments on the recommendations regarding the contents of sales brochures pending the outcome of that Bill.*

Financing Arrangements (Paragraphs 6.40 & 6.41)

- 2.3 The Committee notes that the intention of Recommendation 23 is to enable the purchaser to know from the sales literature the finance scheme available, details of the facilities and interest. However, *the Committee cannot see that such a recommendation will serve any useful purpose.* Irrespective of whether the financial arrangements are to be included in the sales brochures, there are no binding agreements between the banks and the purchasers and ultimately banks are not obliged to provide finance to purchasers. On the other hand, the recommendation will have the adverse effect of encouraging purchasers to act imprudently by not making individual inquiries concerning financial arrangements with different banks before entering into binding preliminary agreements.

Cooling-off period (paragraphs 6.44 – 6.45)

- 2.4 *The Committee supports the proposal for the introduction of a statutory cooling-off period for the purchaser in the first-hand market.*

Right of Inspection Prior to Signing of Preliminary Agreement (paragraph 6.50)

- 2.5 The Sub-Committee recommends that if there is no right of inspection prior to signing of the PSPA, the purchaser of a completed residential unit in the first-hand market should not be liable to forfeiture of his preliminary deposits where he takes advantage of the cooling-off period to cancel the preliminary agreement. ***The Committee takes the view that this recommendation is inconsistent with the recommendation regarding mock-up unit,*** which is introduced to avoid the inconvenience of letting a great number of prospective purchasers inspect completed units. If the purchaser has a cooling-off period and the protection of inspecting a mock up unit, there is no reason for non-forfeiture of the preliminary deposit or 5% of the purchase price, whichever is the lower.

Warranties made to the Developer by the Contractor (paragraph 6.55)

- 2.6 The Committee believes that implementation of Recommendation 29 requires legislative enactment and a change in building contract law.

Duty to Maintain terms of DMC Unchanged (paragraph 6.72)

- 2.7 The Sub-Committee recommends in Recommendation 33 that if an uncompleted development has a DMC, developers should have an obligation to keep its terms unchanged when the development later becomes completed with the issue of the occupation permit.
- 2.8 It is not entirely clear to the Committee as to what this Recommendation is intended to address. It will not be possible to change the terms of a DMC if it is already executed without the consent and agreement of all co-owners. On the other hand, if what the Sub-Committee refers to is the *draft* DMC, the Committee cannot understand the rationale behind prohibiting any changes to its contents. Variation in design and amendments to building plans are very common and may well result in consequential amendment to the DMC. The Committee has brought to the attention of the Sub-Committee that there are already guidelines governing the drafting of the DMC under both the Consent and Non-Consent Scheme and purchasers should already be well protected. Under both the Consent & Non-Consent Scheme the specified/prescribed form of ASP already contains a standard clause restricting to developer's/vendor's right to change the draft DMC except in certain situations. If

the recommendation is intended to prohibit the entering into of Sub-DMC, then property developments in Hong Kong will come to a stale as there cannot be any variations in design in response to market needs. *The Committee would reiterate its request for clarifications on Recommendation 33.*

The Property Committee
The Law Society of Hong Kong
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