



In Perspective – Provisional Agreement, or Option Agreement?

[2011] HKIEA P1

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12 January 2011

Clerk to the Bills Committee on Stamp Duty (Amendment) (No. 2) Bill 2010

Legislative Council Secretariat

Legislative Council Building

8 Jackson Road

Hong Kong

By email : bc_02_10@legco.gov.hk

(Attn. Ms Becky Yu)

Dear Sirs,

Re : Submissions on the proposed Special Stamp Duty ('SSD')

We submit in the following pages our views on the proposed SSD and related issues.

Thank you!

Yours sincerely,

[signed]

Stanley To

Honorary Researcher

Submissions to Legco on the Stamp Duty (Amendment)(No. 2) Bill 2010

A. Introduction

1. Our principal mission being *'to promote fair estate agency practice for the benefit of the Hong Kong general public'*, and with our members and the clients they serve coming from a multi-cultural background often confounded by the vastly different Hong Kong conveyancing pace and practice, we see great merits in the objectives behind the Bill – to arrest the rampant speculation in the residential property market – but are a little concerned about the *added* strain that the Bill might cause practitioners in carrying out their duties.
2. We say *'added'* because certain features of the existing conveyancing practice – *dual agency* and the Hong Kong unique *3-party provisional agreement for sale and purchase ('3p-PASP')* - already test practitioners' ability to *serve clients with honesty, fidelity and integrity*¹ and *protect and promote client interests*² to its limit. Our concern in this regard is summarized in the annexed article entitled *'The Tripartite Provisional Agreement for Sale and Purchase – R. I. P.'* (*'the 3p-PASP Report'*, No. [2009] HKIEA 1)³ and will not be repeated here.
3. While we share most of the views submitted to the Bills Committee so far, our submissions below will only focus on matters arising from the Bill which may impinge on estate agency practice directly, namely :
 - the alien concept of equitable interest
 - the conventional wisdom that a provisional agreement is binding
 - the possible impact on practitioners' livelihood.
4. We make certain proposals at the end hoping to stimulate debate on ways to improve the estate agency and related conveyancing practice in Hong Kong.

B. The alien concept of equitable interest

5. Much of the controversy centres around IRD's interpretation in its *'Introduction to the SSD'* that *'the date of acquisition is the date on which the purchaser acquires the equitable ownership or legal ownership of a property, whichever is earlier.'* Further *'if provisional agreement only allows the buyer, in the event of defaults*

¹ Code of Ethics 3.3.1, Estate Agents Authority ('EAA')

² Code of Ethics 3.4.1

³ posted at Practitioners' page of www.hkiea.hk

*by the seller, to claim a damage from the seller which is usually equal to the amount of the deposit paid, but otherwise has no right to claim for specific performance of the contract, the equitable ownership of the property does not pass to the buyer under the agreement. Therefore, the buyer is only regarded as having "acquired" the property under the formal agreement executed [on date]*⁴. (emphasis added)

6. While it may be intellectually challenging for the IRD and the learned profession to debate the precise time when equitable ownership passes, one must not lose sight of certain basic facts about the average Hong Kong estate agent (who will commit his client to sign the 3p-PASP invariably without prior legal advice) :
 - a. the entry training requirement is low. There is no need to attend any training course before sitting the qualifying examination;⁵
 - b. while **Basic Concept of Equity** is included in the examination syllabi⁶, scant reference on the subject is made in the Study Guide and other reference material of the Estate Agents Authority ('EAA'). The same can be said of textbooks/examination guides published in Chinese by major estate agency trainers. Even if there is coverage, anyone who has studied equity will appreciate that it is not a subject that can be easily self-taught.
7. Unless the training syllabi/entry training threshold for estate agents (referring to both estate agents and salespersons) are improved, one can foresee the court being further clogged with law suits which could have been avoided.

C. Conventional wisdom - a provisional agreement is binding

8. Estate agents are required to explain to the client any essential terms and provisions in the agreement for sale and purchase⁷. The agreement should reflect the parties' intention which in turn is determined by what their estate agents tell them. Given the present state of estate agents' basic training, it may be

⁴ Q 7 Questions and Answers http://www.eaa.org.hk/SSD_notice_2010-12-20_eng.pdf

⁵ EAA has stopped accrediting or recognizing courses providing basic training. So even if a candidate (non Chinese speaking one in particular) wishes to receive proper training to prepare for the qualifying examinations, he is left to his own devices. The writer declares interest that he teaches a practitioners' course which has a different focus and does outline equity principles such as express and implied trusts and estoppel.

⁶ Part 3, Section 3.2 estate agents' qualifying examination syllabus.

⁷ Section 13(1) *Estate Agents Practice (General Duties and Hong Kong Residential Properties) Regulation*, Cap. 511

legitimate to ask how many clients would be told that the 3p-PASP that they sign is not necessarily a binding agreement. It would take massive re-training to rewire practitioners' conventional wisdom.

9. In this regard, we have tried to help consumers to see the 3p-PASP in perspective by explaining in layman terms as follows⁸ :

A 3p-PASP, though a concluded agreement, normally incorporates escape clauses giving either party the choice of 'alternative performance'. This means that either party could sell or buy the property in accordance with the terms of the agreement. However, if he changes his mind before the formal agreement is signed, he could take the alternative escape course by paying compensation equal to the initial deposit to the other party (if the vendor changes his mind), or forgoing the initial deposit (if purchaser). The agreement will then be discharged and the innocent party, even if he suffers greater loss, will have no other remedies against the party who withdraws.

10. On the other hand, contrary to IRD's suggestion, there need not be any 'default' before a provisional agreement is rendered non-binding. Depending on the wording of the provisional agreement, not proceeding could simply be an alternate route of performance involving no fault element⁹. The *provisional sale and purchase agreement* of the Law Society of Hong Kong allows either party to elect to *withdraw* by paying the amount similar to that commonly specified in the 3p-PASP¹⁰. It is hard to equate a withdrawal in such circumstances with default.

D. Impact on practitioners' livelihood

11. From the practitioners' view point, IRD's interpretation might adversely impact on their livelihood if its effect is spilled over to the interpretation of the estate agency agreement.
12. It is stipulated in the commission schedule of the prescribed estate agency agreements (Form 3, 4, 5 and 6) that the client is liable to pay the agent a commission if the client enters into a '*binding agreement*' through the agent

⁸ Para. 2.1 of Commentary '*Observations on the Three-party Provisional Agreement for Sale and Purchase*' [2010] HKIEA C2, at Consumers page of www.hkiea.hk

⁹ *See To Keung v Sunny Way Ltd* [2009] 5 HKLRD 300

¹⁰ Clause 18 has '*cooling off*' effect - '*At any time on or prior to the date for signature of the formal agreement for sale and purchase pursuant to Clause 7 either party may by written notice to the other withdraw from this agreement...*' http://www.hklawsoc.org.hk/pub_e/resource/bilingual.asp Section C

during the agency period. Binding agreement is understood to include a 3p-PASP, or at least no issue appears to have been taken regarding the escape clauses in it so far.

13. If the IRD suggestion - that a provisional agreement with escape clauses is not binding - gains momentum, practitioners might lose their claim to the reward for their work. Care must be taken not to allow any unintended 'spill over' effect.

E. Time to overhaul the provisional / formal agreement 2-stage process

14. Enough of the court's time and clients' money have been wasted in debating the nuances of the multifarious (and often poorly drafted) 3p-PASPs that some long term solution ought to be found. They differ from one another¹¹ and even within the same document the Chinese version may not agree with the English¹². The proposed SSD may magnify the problem many times over¹³. Further, for the reasons outlined in the annexed *3p-PASP Report*, this pity state of affairs ought to be stopped soonest calling for perhaps some radical rethinking.

15. It is beyond us, a practitioners' non-profit organization bereft of resources, to resolve a long standing problem impacting on all property owners in Hong Kong that various regulators have for decades failed to notice or tackle. We would therefore put forward the suggestions below in the hope that they may end up as agenda items somewhere sometime.

F. Option to Purchase

16. We suggest that, to remove future misunderstanding, the present 3p-PASP be modified to become (and be called) an option to purchase ('Option') between the vendor and purchaser. The client/agent relationship is adequately covered in the prescribed estate agency agreement so the agent need not be a party to the Option agreement¹⁴.

¹¹ See the oft cited *Lee Ching Ming Stephen v Man Sun Finance (International) Corporation Ltd* CACV 203/1992, which was distinguished in *See To Keung* (supra)

¹² *Wise Think Global Limited v Finance Worldwide Limited* HCMP 571/2010 is one recent example. The default compensation clause says 'deposit' in Chinese but 'initial deposit' in English; and the language choice clause says in Chinese 'this agreement is to be interpreted in Chinese/English' but in English 'This Agreement should be interpreted in the Chinese/English version in case of ambiguities'. Imagine the absurdity when the provisional agreement is interpreted to the English vendor by an expatriate estate agent while the Chinese purchaser is explained the Chinese version by a Chinese estate agent.

¹³ Unless EAA provides the draft clauses (and mandate their compliance) to enable practitioners to heed IRD's suggested ways to 'protect the interest of the buyer and the seller', as mentioned in their *Introduction to the SSD*. It will be a vast duplication of effort for the 31,000 licensees to draft the clauses by themselves, even if they are capable of drafting them.

¹⁴ The *3p-PASP Report* has explained why certain clauses in the common 3p-PASP may be unethical.

17. Key terms of the Option:

- a. standard provisions : property, price, parties, time schedule, payment schedule;
- b. specific provisions : the 2nd Schedule Part A Cap. 219 will be incorporated save and except encumbrances and other matters disclosed to the purchaser or things expressly stated in the Option;
- c. the vendor is to (i) tender within [12] days a draft sale and purchase agreement (no provisional/formal distinction) per the Option terms and (ii) execute it within [2 days] of the purchaser executing it. If the vendors fails (or chooses not) to comply the Option deposit is to be returned to the purchaser together with a equivalent sum as compensation. This is the only remedy open to the purchaser who can make no further claim;
- d. if the vendor complies but the purchaser chooses not to comply within [2] days of receiving the draft agreement from the vendor, the Option deposit is to be forfeited by the vendor and that is the end of the matter. The vendor can make no further claim;
- e. the Option lapses :
 - (i) automatically when not complied with within the stipulated time and nothing need be done to invoke the forfeiture provision. However, if solicitors have been appointed then professional etiquette would suggest the issue of a letter before termination; or
 - (ii) when the resultant agreement for sale and purchase is signed through solicitors acting for both parties.

18. The Option is not a binding land contract for the reason that no equitable interests pass under it. As a result, the estate agent is not entitled to agency commission unless and until the agreement for sale and purchase is executed.

19. This may appear harsh at first sight, but the fate of the estate agent under the proposal will be no worse than his counterpart in England whose 'subject to

contract' agreement does not proceed further, or one in Sydney where a purchaser exercises his right to withdraw within the 5-day cooling off period. To protect his own interest, the estate agent should arrange the client to engage his solicitors as soon as the client becomes serious in a sale or purchase.

20. The Option deposit, given the transient nature of the Option, can be lowered to 1%. This may encourage the parties to engage their solicitors early¹⁵.

G. One-step Sale and purchase agreement

21. The vendor's solicitors are to draft the sale and purchase agreement ('ASP') per the Option terms which is no different from the present practice.

22. A few key points under the proposal :

- (a) as many vendors would already have in mind the appointment of certain solicitors when their property is listed, the draft ASP should be readily available in most cases. In Hong Kong where unauthorized building works are so common (not to mention the archaic title deed registration system), having legal advice at the early stage of sale will certainly be in the vendor's interest. If this is the case, then it goes without saying that the purchaser should also be represented by solicitors before committing to any purchase;
- (b) the vendor's agent in possession of the draft ASP should provide it to any potential purchaser who appears serious about the deal so that he can consult his solicitors early;
- (c) if both parties' solicitors agree, they can arrange execution of the ASP direct bypassing the Option. It will therefore be in the estate agent's own interest to facilitate this happening as his agency commission is dependent on a binding agreement being executed;
- (d) if the draft ASP is available early, the parties need not wait 14 days to execute it. 14 days becomes the latest time for a binding agreement¹⁶.

23. The proposal is a hybrid between the Hong Kong first sale model and the Sydney

¹⁵ The writer is a non-practising solicitor and has not been associated with any legal practice since 1998. He has a regulatory, not conveyancing, background.

¹⁶ As the ASP, not the Option, is to be stamped, the 14-day interval between the provisional agreement and formal agreement for stamping purpose may become history.

conveyancing practice. The vendor there must give his solicitors' draft ASP to the estate agent before the latter can market the property for him. The interested purchaser can sign the ASP with the estate agent. In this case the ASP so signed will be subject to a 5-day cooling-off period during which the purchaser can withdraw subject to a small money penalty. This is akin to the Option Agreement proposed above.

24. To shorten the waiting time, the vendor can insist on dealing directly with the purchaser's solicitors because only solicitors can waive the cooling-off period. An ASP executed through the parties' solicitors may become binding as soon as signed. The cooling-off period will then not apply.

H. Looking to the future

25. It is hoped that the proposals above may better serve the interests of (potential) property owners and practitioners alike, or at least would provide a platform for reviewing the present estate agency and conveyancing practice. And of course title registration is just around the corner!

Stanley To
Honorary Researcher

Annex : 'The Tripartite Provisional Agreement for Sale and Purchase – R. I. P.' Report – posted at Practitioners' page www.hkiea.hk

Important notice:

In Perspective is to share thoughts with students and practitioners of estate agency practice and to elicit alternative view points. It may not necessarily reflect the stand of the Institute, if indeed there is any stand. Opinion expressed should **under no circumstances be taken as legal advice** as only the court or EAA can interpret the law or enforcement policies. Please consult your solicitor or EAA on questions of law or policy. Comments welcome: research@hkiea.hk.

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