

proof required has now been relaxed and the court will order rectification upon 'convincing proof'.<sup>368</sup>

Rectification, being an equitable remedy, will no longer be available if there has been a long delay in bringing the action or if the land has come into the ownership of a bona fide purchaser without notice of the grounds for rectification.

### Mode of Rectification and Registration of Deed of Rectification

The proper manner of rectifying an assignment is by a deed of rectification which must be registered in the Land Registry. Whether or not the Registry should register such a deed was considered by Le Pichon J in *On Tak Development Ltd v Ng Woon Tong*.<sup>369</sup> The first plaintiff assigned car park No 95 to the defendant in 1988 and the defendant was registered as owner. The following year, the first plaintiff assigned car park No 95 to the second plaintiff in error when he should have assigned car park No 89. This latter assignment was also registered. When the error was discovered, the first and second plaintiffs entered into a deed of rectification and confirmation by substituting car park No 89 in place of car park No 95. The Land Registry, however, refused to register the deed of rectification insisting that the second plaintiff reassign car park No 95 to the first plaintiff. The plaintiffs applied to the court for a declaration that the deed of rectification was sufficient to rectify the error. Le Pichon J pointed out that the stance taken by the Land Registry was untenable since the first plaintiff had title to car park No 95 at the date of its assignment to the second plaintiff and no interest had vested in the second plaintiff that could be reassigned to the first plaintiff. The deed of rectification should have been registered by the Land Registry and the declaration sought was made.

<sup>368</sup> *Joscelyne v Nissen* [1970] 2 QB 86.

<sup>369</sup> HCMP 1004/1996, 11 June 1996, unreported.

## Chapter 13

# Security Transactions Over Land

## A Introduction

### 1 Background

Since 1 November 1984, the only form of legal security over land has been that of a 'mortgage of a legal estate may be effected at law only by a charge by deed expressed to be a legal charge'.<sup>1</sup> Whilst the form of the legal mortgage is that of a charge, a hypothecation, section 44(2) provides that the parties have the same protection, powers and remedies as if the charge were a legal mortgage. The form of the mortgage is that of a charge, that is a hypothecation, with nothing being transferred to the chargee; the substance is that of a traditional mortgage in which Equity gives special protection to the mortgagor.<sup>2</sup> It should be noted that this charge is legal not equitable. A charge over the undertaking of a company, is an equitable charge which does not give the chargee power to pass title on the sale of the asset; instead the charge requires a court order to sell to be able to pass title. This form of charge is commonly contained in a debenture which not only acknowledges the debt, and contains a promise to repay, but also provides for all forms of security to be taken by the lender over land as well as personalty.<sup>3</sup> The chargee will insert into the charge various devices to enable the chargee to exercise appropriate rights on the default of the chargor, such as a Power of Attorney by the chargor to the chargee or his nominee to enable the chargee to sell or appoint a receiver. Another device is a blank Assignment or Transfer (of personalty) where the chargor, on entry into the charge, gives the chargee an Assignment or Transfer executed by the chargor but blank as to the assignee or transferee; this too enables the chargee to speedily take action to protect his interest on default. The charge over company

<sup>1</sup> Section 44(1) of the Conveyancing and Property Ordinance (Cap 219).

<sup>2</sup> *Ibid.*, s 44(2).

<sup>3</sup> *Government Stock & Co Ltd v Manila Railway Co* [1897] AC 81.

property must be registered under section 80 of the Companies Ordinance (Cap 32). In most cases, the chargee will have written into the contract various protective steps to make unnecessary application to the court for resale, including the appointment of an attorney under power.

## 2. Traditional Mortgage

A mortgage is described as:

'a conveyance of land ... as a security for the payment of a debt or the discharge of some other obligation for which it is given. This is the idea of a mortgage, and the security is redeemable on the payment or discharge of such debt or obligation, the provision to the contrary notwithstanding.'<sup>4</sup>

Thus, it is the security part of a secured loan transaction under which property is used as collateral or security for a loan and where the mortgagor, qua debtor, is subject to a personal covenant for the repayment of the debt. The mortgage comprises both a contract as well as a property transaction, namely, the collateral transaction of security which creates an interest in land. The contract part of the transaction is governed by general contractual principles. Time, for the performance of the terms of this contract, is usually of the essence, meaning that failure to perform timeously will generally terminate the rights of the mortgagor under the contract, including that of redemption by allowing the mortgagee to foreclose and take absolute title in the land. Equity intervenes to protect the proprietary interest of the mortgagor in the land by extending the time for repayment under the contract of redemption but does not do so indefinitely.

The security interest results from the assignment of the legal estate to the mortgagee, although this is not an absolute assignment because it is subject to the creation of the contractual equity of redemption, and later the equitable right to redeem. The presence of the security element has two main effects: first, it enables relief against the land itself because it creates a proprietary interest in the land and, secondly, it enables the intervention of equity. Whilst the usual contractual remedies for breach will apply to the contract part of the transaction, the exercise of the 'security' remedies may be subject to certain requirements additional to the actual breach. For example, notice of default may be required before the mortgagee can take action to sell the land.

The essence of a traditional mortgage consisted of:

- (a) the use of the property as security for, or as an earnest of, the repayment of a debt. The form of the security is that of transfer or assignment of the legal title to the land;

the personal covenant to repay which is a contractual obligation linked to the ability of the borrower to recover his property, and which is independent from the security element. This personal obligation remains binding on the mortgagor, if unsatisfied, despite the sale of the property by the lender on default. If the land is sold, then any excess received, after payment of all costs and expenses, is paid to the mortgagor; this is treated as being equivalent to returning the property. Sale does not vest the equitable interest of the mortgagor in the mortgagee, except in rare cases where the mortgagee is entitled to purchase at the sale. In respect of the excess on sale, the mortgagee is treated as a trustee for the mortgagor. But where, after sale, there remains a balance unpaid, the mortgagor must satisfy that balance. For this purpose, the personal covenant remains active and in force until it has been discharged. This situation is quite different from that of foreclosure. After the order absolute, the mortgagee may sell, and retain any profit made on that sale; this is because foreclosure has the effect of merging the interest held by the mortgagor during the currency of the mortgage has been vested in the mortgagee, so that he now owns the land absolutely, ie with legal and equitable title. Once the lender is unable to return the property or money equivalent, as happens on foreclosure, the personal covenant, even if unsatisfied, is extinguished;

- (b) the creation of the 'equity of redemption' or the right to discharge the encumbrance either as a contractual right for which time is of the essence up until the time of default, or, on the termination of such right on the due date if there is default in repayment, the indulgent equitable extension of the time for redemption; and
- (c) the remedies of the lender enforceable in various ways against the land. The presence of these remedies does not detract from the right of the mortgagee to sue for a judgment debt on the covenant to pay.

In *Faricho Investment Ltd v Good Time Finance Ltd*,<sup>5</sup> a company borrowed from the defendant and executed (a) a legal charge over two pieces of land; (b) a power of attorney in favour of the lender; (c) a guarantee (presumably personal guarantees by the two shareholders); and (d) a loan agreement. After observing the terms of the loan contract for one year, the company was 11 days late in making a payment. The mortgagee served notice of demand for an amount which was later said to have 'overstated by a considerable margin' the amount due. The company attempted to find out how the amount claimed had been calculated but the mortgagee was uncooperative. The mortgagor then discovered the mortgagee had

<sup>4</sup> *Santley v Wilde* [1899] 2 Ch 474 at 474 per Lord Lindley MR.

<sup>5</sup> [2006] HKCU 1282 (HCA 2496/2005, 25 July 2006, unreported).

similar notice. *Barnes J* ruled that notice under the Roads (Works and Compensation) Ordinance (Cap 370) came within the description of 'any similar notice' and the purchasers were allowed to rescind. However, however, deprived the purchaser of a similar advantage.

The purchaser's solicitor should also provide expressly in the and purchase agreement that such terms survive completion to avoid adverse consequences of the principle of merger.

## Chapter 8

# Formation of Contract for Sale of Land

## Introduction

### Duality of Contract for Sale of Land

The outstanding characteristic of the contract for the sale of land which distinguishes it from most other contracts is its dual nature in that it is both a contract as well as a transaction whose ultimate effect is to create proprietary rights in land which are governed by property law but which until completion are governed by the general law of contract. Until the rights have been transferred to the purchaser, in equity or at law, the transaction is regulated under general contractual principles including such as formation, validity, and discharge. Thus, the principles of mistake, misrepresentation and illegality are applicable without limitation to the subject matter although in the grant of relief, the equitable element may be significant in that specific performance might be awarded rather than common law damages. Thereafter the contractual elements tend to be merged into the property elements of the transaction, attaching in the purchaser (or lessee or mortgagee or other party) forming the proprietary interest contracted for.

Further in granting equitable relief, a court may well be disposed to ignore the illegality of the underlying transaction and to grant relief by way of a trust which protects an equitable interest in the land, perhaps as a constructive trust. To do this, beguilingly the court is able to use the illegal contract (which should be treated as void) as the basis for the proprietary interest which results; only the ingenuity of equity could produce such results. *Tinsley v Milligan*<sup>1</sup> and *Tribe v Tribe*.<sup>2</sup>

In *Tinsley* it was said that if a claimant to an interest in property can establish his interest without needing to plead or rely on an illegality, then his interest

147 [1990] 2 HKLR 480, [1990] 2 HKC 401 (HC).

<sup>1</sup> [1991] ANZ ConvR 420, [1994] 1 AC 340, [1993] 3 All ER 425.

<sup>2</sup> [1991] ANZ ConvR 287, [1995] 3 WLR 913, [1995] 4 All ER 236.

in property will be confirmed by the court if he can show how facts leading to a recognized right such as under a common intention constructive trust. In *Tinsley* the claimant could show a common intention on the acquisition of the property that both plaintiff and defendant would share the title, and that the plaintiff had made financial contribution to the payment for the property; hence it was decided that she had an equitable interest under the constructive trust, despite the fact that she had obtained the money used from an illegal activity, namely a falsely claimed entitlement to a pension. In *Tribe* the claimant sought to reverse a purported gift of property made to avoid potential tax liability; he was found entitled to do so on the basis that he had repented before the transaction had been concluded. This was so even though he was not liable for the tax. The court found it could overlook his intention to defraud the revenue. In *Wong Kwok Learn Baldwin & Anor v Internation Trading Company Ltd*,<sup>3</sup> the court considered the sale of shares in an accounting firm in 1965 effected without consideration, and where the purchasers were said to hold them beneficially for the vendor. The purpose of the transaction was to remove them from the possibility that they could be taken to settle a claim for damages for professional negligence by the vendor. The claim was settled in 1970 and the firm paid compensation. The Court of Appeal held that because of the fact acknowledged by the buyers that they held the shares in trust for the vendor the plaintiff did not have to rely on any illegality to support the claim; consequently the resulting trust was effective and the court ordered the shares to be vested in the plaintiff.

The court did refer to the decision in *Loyal Luck Trading Ltd v Chun Wah*,<sup>4</sup> where the Court of Appeal had referred to *Nelson & Anor v Nelson & Ors*<sup>5</sup> which had not followed *Tinsley* on the basis that the plea in *Nelson* was contrary to legislative provisions, and the High Court could not allow the parties to negate the legislation. In his judgment, Tang VP in *Loyal Luck* had said that:

'The potential conflict between *Tinsley v Milligan* and *Nelson & Another v Nelson & Others* can only be resolved by the Court of Final Appeal. On the basis of *Tinsley v Milligan*, I agree... that it is not necessary for the plaintiff to plead or rely on illegality.'

In *Wong Kwok*, the Court of Appeal followed *Tinsley*, leaving open for the Court of Final Appeal the question of whether the *Nelson* decision was appropriate for Hong Kong. See also the decision in *Cheerbond*

*Development Ltd v Tung Kwok Yu*,<sup>6</sup> and that in *Tiu Sum Fat & Ors v Shun Development Ltd & Anor*.<sup>7</sup>

The duality of the nature of the transaction is of limited importance, except as to form, until the proprietary interest has been created. In previous years, there was reluctance to apply contractual doctrines such as frustration and repudiation to land contracts, especially leases. This reluctance has been replaced by a grudging admission that land contracts are not 'immune' from frustration although it will be the exception rather than the rule. Further repudiation is readily available as a source of relief in land contracts to indicate the breach of essential time stipulations.

Once the proprietary rights have been transferred to the purchaser, then there is no necessary connection with the contract itself for enforcement purposes. This is because the contract has been subsumed into the assignment. The contractual rights have either become equitable as, for example, under a bare trust, or the contract has merged in the assignment. In such cases, the protection given by the nominate relationship is perhaps more efficacious than that given by the contract.

When the proprietary rights of the purchaser come into existence, the contract will be subsumed into that new relationship. For example, if the contractual rights have become translated into the equitable interest of a beneficiary under a bare trust that status will offer a more efficacious protection to the purchaser than will mere contractual rights in a contest with a competing purchaser: *Lysaght v Edwards*,<sup>8</sup> *Rayner v Preston*,<sup>9</sup> *Pang Wing-shui v Alhambra Investment Co Ltd*,<sup>10</sup> *In Re Hong Kong Home Building and Investment Co Ltd (In Voluntary Liquidation)*.<sup>11</sup>

Obviously, when the contractual rights have merged into the assignment, the contract will become redundant. Sometimes the identification of the proprietary right is clearer towards, or at the end of the contract. But entry into the contract also creates certain proprietary rights in the land, and often it is the proprietary rights which give more useful protection to the purchaser.

Whilst usually there is no danger in subsuming a contract into the rights arising under a later instrument, the decision of *Goss v Chilcott*<sup>12</sup> shows what can happen when the subsequent instrument is declared void. In that case an oral agreement of loan was subsumed into a formal mortgage

3 [2010] 2 HKLRD 334, [2010] 3 HKC 296.

4 [2008] 4 HKLRD 681, [2008] 4 HKC 257.

5 (1995) 184 CLR 538, (1995) 132 ALR 133.

6 [2010] 2 HKLRD 546, [2010] 3 HKC 530.

7 [2010] 1 HKLRD 553, [2010] 1 HKC 258.

8 (1876) 2 Ch D 499.

9 (1881) 18 Ch D 1.

10 [1965] HKLR 163, [1965] HKCU 18.

11 [1966] HKLR 293, [1966] HKCU 28.

12 [1997] 2 All ER 110.

instrument; however, the mortgage was materially altered by an agreement between the mortgagee and the mortgagors. Relief was granted to the lender on the ground of restitution based on total failure of consideration. However, this relief may not always be available as an alternative to relief through debt.

If the contract does not proceed to completion because of the purchaser's breach, any lien which the purchaser may have had in respect of the deposit money will be terminated if the vendor has a right to forfeit the initial and later deposits. Thus in *Fung Kan Wai v Leung Shui*,<sup>13</sup> the purchasers were treated by the vendors as having repudiated the contract with the result that the vendors forfeited the deposits. Prior to the vendors selling the land to a third party, the original purchasers sought specific performance of the contract, thereby disputing the repudiation of the contract. Later, the purchasers abandoned the action for specific performance, and registered a *lis pendens* claiming a lien over the land. The Court of Appeal allowed forfeiture of the initial deposit, in accordance with the terms of the contract. The registration of the *lis pendens* was held to be improper because the purchasers did not have a proprietary interest in the land because repudiation had terminated not only the contract but also the proprietary interest which arose out of the contract.

By contrast in *Karex (Hong Kong) Ltd v Fortune Talent Development Ltd*,<sup>14</sup> the failure of the vendor to answer requisitions caused the contract to be determined. The plaintiff was the last purchaser at the end of a series of sub-sales, and the vendor, on whom the requisitions had been served, was himself a sub-purchaser. On refusal to answer the requisition, the vendor had forfeited the deposit. The plaintiff claimed that the deposit had been held by preceding parties as constructive trustees for him. Subsequently, the head vendor and the head purchaser entered into a cancellation agreement. The plaintiff had registered a *lis pendens*, and the head vendor sought its removal. The head vendor had been described as vendor in the property in all contracts.

The plaintiff based the claim to the lien on the payment of the deposit but relied for its protection on the fact that:

"The predominance of authority seems to me to be to the effect that a vendor becomes a constructive trustee for a purchaser who has paid part of the purchase money on the purchaser's assigns of whom he has notice; and that the purchaser is entitled to an equitable lien upon the vendor's interest in the property to secure his payment if the contract and purchase agreement goes off, and presumably likewise their assigns."

Consequently registration of the *lis pendens* was not to be vacated because there was an arguable case.

13 [1999] 4 HKC 70.

14 [1999] 3 HKLRD 397, [1999] 4 HKC 203.

15 Per Nazareth VP at 210.

Nazareth VP and Mayo JA (Rogers JA not commenting on this point) treated the vendor as a constructive trustee. Perhaps this was the same type of relationship as the usual bare trust arising under the doctrine of sub-sale: see *Rayner v Preston*,<sup>16</sup> *Shaw v Foster*,<sup>17</sup> and *Pong Wing-shui v Pong Wing Investment Co Ltd*.<sup>18</sup>

A contract for the sale of land or of an interest in land is no different from any other contract in the need to comply with the essential features of an enforceable agreement, namely, offer, acceptance, consideration and intention to effect legal relations.<sup>19</sup> In this, it does not differ from any other contract. However, there are several features of a contract for the sale of land which are special.

First, the contract for the sale of land must be in writing in compliance with the formal requirements of section 3(1) of the Conveyancing and Property Ordinance (Cap 219) or be evidenced by sufficient acts of part performance, in complying with section 3(2). Section 3(2) takes the form of an agreement outside the terms of section 3(1) to enable relief in equity to be granted to save the transaction. Section 3(1) is the only survivor of section 4 of the Statute of Frauds in Hong Kong. In England the Law of Property (Miscellaneous Provisions) Act 1989 abolished the doctrine of part performance thereby requiring all contracts for the sale and purchase of land to be in writing to satisfy section 4. Exceptions are permitted in respect of certain transactions such as mortgages, implied and constructive trusts.<sup>20</sup>

Second, where the bare essentials of details of parties, property, price, and completion date are present together with evidence of the intention to effect legal relations, the contract is referred to as an 'open contract'. Often, there is some form of writing as to these essential details, but not enough to constitute a formal contract because of the manner of writing and the inadequacy of terms. It is rare to find a contract for the sale and purchase of land which is wholly oral. Such a contract would be unenforceable at law but not void.<sup>21</sup> If the plaintiff can then show his performance of acts sufficient to enable him to seek specific performance pursuant to section 3(2) of the Conveyancing and Property Ordinance (Cap 219) the absence of formal writing is irrelevant. However, it should be remembered that equitable relief is discretionary and there is no guarantee that a court will grant the relief sought, nor the alternative relief of damages in equity.

<sup>16</sup> (1848) 18 Ch D 1.

<sup>17</sup> (1872) 1 ER 5 HL 321.

<sup>18</sup> [1965] HKLR 163, [1965] HKCU 18.

<sup>19</sup> *Chater Co Ltd v Tsang Yuk Kiu* [1997] 1 HKLRD 863, [1997] 2 HKC 442.

<sup>20</sup> See *Chastonstrenght Ltd v International Glass Engineering* [2003] UKHL 17, [2003] 2 All ER 615.

<sup>21</sup> *Esau Shu Man Joshua v Yaacov Ozer* [1999] 1 HKLRP 216, [1999] 1 HKC 150.