

At the Mercy of Creditors: Liability of Co-owners in Hong Kong's Multi-storey Buildings

Introduction

On 24 October 2017, Hong Kong's Court of First Instance handed down its judgment in *Wong Tak Man Stephen and Osman Mohammed Arab, The Joint and Several Liquidators of the Incorporated Owners of Nos. 6, 6A, 6B, 8, 10, 12, 14 and 16 Wing Kwong Street (in compulsory liquidation) v. Chang Ching Wai & Chang Din Wah* (the "Judgment").

In this case, the Plaintiffs were the liquidators of the Incorporated Owners (IO) of the subject building. The Defendants were two of the owners of the building. Expensive refurbishment work was performed on the building before 2009, and the IO found itself unable to pay the fees of the construction company. The IO was wound up with unpaid debts of some HK\$3.6 million.

In order to settle the said debts and liabilities, the Plaintiffs had previously taken steps to recoup contributions from the owners of the Building according to their respective shares in the Building. A substantial number of owners of the Building (including the 1st and 2nd Defendants) had failed to make their contributions to the refurbishment work. The Plaintiffs then obtained leave from Harris J to commence proceedings against each and every owner of the Building, including the present proceedings against the 1st and 2nd Defendants, seeking a declaration that the 1st and 2nd Defendants shall be jointly and severally liable for all the debts and liabilities of the IO and an order for payment of some HK\$3.6 million. The 2nd Defendant is the father of the 1st Defendant, and was of advanced age and could not appear in court. The 1st Defendant, acting in person, appeared and argued that they should not be liable and questioned the sum payable for the refurbishment work and the apportionment of such sum amongst the owners of the Building.

The Court order is in favour of the Plaintiffs. Hence, the liability for the entire sum owed by the IO fell on the 1st and 2nd Defendants.

The consequences of the Judgment are troubling and significant. It affects everyone who owns undivided shares in a building with an IO.

Issue at Stake

One might wonder how one or two individual owners could possibly be held liable for the debts of the IO, which is the body representing the interests and rights of all of the owners of a building. The answer lies in section 34 of the Buildings Management Ordinance (Cap 344) (BMO), which is unique to Hong Kong. The section reads:

"In the winding up of a corporation under section 33, the owners shall be liable, both jointly and severally, to contribute, according to their respective shares, to the assets of the corporation to an amount sufficient to discharge its debts and liabilities." (emphasis added)

The interplay of the highlighted phrases is key.

In an earlier decision decided in 2005, *Re Incorporated Owners of Foremost Building* [2005] 3 HKLRD 509, Madam Justice Kwan (as she then was) considered this issue but did not decide on it.

Essentially, there are two ways of reading the section:

1. *The owners of a building may be pursued individually ("severally"), but their liability to the creditor is limited to the extent of their proportionate ownership of the shares in the building.* Under this reading, if the debts owed amount to HK\$10 million, but an owner only owns 1% of the shares, the creditor can only claim HK\$100,000 against him.

2. *The owners of a building may be pursued individually for the entire debt, after which they can seek contribution from fellow owners of the building.* Under this reading, the risk falls on the owners entirely. The creditor is entitled to all of the enforcement methods against individual owners, while those owners have to commence separate litigation proceedings against fellow owners to recoup their losses.

The Court in the Judgment opted for the second interpretation. We set out the Judge’s reasoning below and explain the potential ramifications.

The Judge’s Reasoning

The Judge noted that Section 34 of the BMO replaced a similar section in the old Multi-Storey Buildings (Owners Incorporation) Ordinance. Section 34 of the BMO added the words “*both jointly and severally*”. In his view, these words changed the limit and extent of an owner’s liability under the old regime.

The Judge considered that this meant the newly added wording, “*both jointly and severally*”, would take precedence over the existing wording “*according to their respective shares*”. In other words, the creditor is entitled to sue the owners jointly and severally, and the “*respective shares*” language is limited to the owners sorting out the extent of their respective liabilities amongst themselves.

Further, the Judge examined the greater context of the BMO. He cited section 17(1) of the BMO, which allows that any judgment made against an owners’ corporation may be enforced, with leave of the Lands Tribunal, against any owner. That section, which takes effect when the corporation is solvent (as opposed to section 34 which operates in an insolvency situation), did not provide that the owner would receive any limited liability protection according to the owner’s share in the building.

Section 17(1) had been previously considered by the Court of Final Appeal in *Chi Kit Co Ltd & Anor v. Lucky Health International Enterprise Limited* [2000] 2 HKLRD 503, which involves a HK\$25 million claim against the incorporated owners in that case. It was held that the Lands Tribunal had the power to allow execution of such a judgment against a single owner. In a side comment, Justice Litton noted that the unfortunate owner would have to seek contribution from the fellow owners himself.

Drawing the above threads together, the Judge concluded that the legislative intent behind the BMO is to favour creditors over owners, since in a successful claim against a corporation, the creditors are the innocent party. Only the second interpretation of section 34 would give substance to such legislative intent.

Consequences of the Judgment

While it must be right that creditors are the innocent parties in a debt situation, the question is how the balance of power should lie, especially with regard to the sprawling housing estates which are so common in Hong Kong.

Many buildings in Hong Kong are aging and require significant renovations, for example, to refurbish the exterior walls or to bring the building in line with updated fire codes. It is very likely that there will consequently be claims against owners based on renovation costs (such as the Judgment) or due to personal injuries sustained at the common parts of the building (*Chi Kit Co Ltd*).

There are some safeguards for owners. An Owners’ Incorporation is mandated by law to obtain property insurance at a minimum of HK\$10 million per risk event. Claims against individual owners under section 17 of the BMO, as noted above, require the Lands Tribunal to exercise its discretion to allow enforcement, which provides protection against extreme hardship.

However, as can be seen from the Judgment, all bets are off in an insolvency situation, and also where insurance does not cover the claim. The creditor is fully entitled to single out owners, especially those whose flats are not subject to mortgage. If the creditor is so minded, it could even pursue other landed properties of those owners, or even bankrupt them in due course. In certain estates where there are hundreds of owners, the implication is that a single owner can conceivably be responsible for the liabilities and debts of all the other owners who fail to pay. The creditors would have a “target rich environment” to select exposed owners and recover all their losses from those owners.

The Defendants in the Judgment were not legally represented. It is likely that the Judgment will stand without appeal. It remains to be seen whether creditors of building owners will take advantage of the Judgment for their purposes.

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