

Executive Summary of the Investigation Report on Letting of Market Stalls by Auction

Background

In Hong Kong, there are 104 public markets providing some 15,500 market stalls. These markets were previously managed by the Urban Services Department and the Regional Services Department. Since 2000, the Food and Environmental Hygiene Department (“FEHD”) has taken over.

2. Public market stalls are usually let by auction. In the course of complaint handling, we noted that the arrangements for auction carry opportunities for abuse. A tenant may set out to outbid competitors to secure nearby stalls, then terminate the tenancy prematurely, thereby eliminating or reducing competition. As stalls vacated shortly after an auction are not auctioned again until three to five months later, the same bidder may repeat such tactics and thus enjoy a *de facto* monopoly. This is unfair to other bidders and particularly to patrons of the market. After preliminary inquiries into the administrative arrangements of FEHD for letting public market stalls, The Ombudsman decided to initiate a direct investigation under section 7(1)(a)(ii) of The Ombudsman Ordinance, Cap. 397. In a press conference held on 4 November 2004, The Ombudsman declared this direct investigation.

The Ambit

3. The ambit of this direct investigation is:
- (a) to examine administrative arrangements for letting public market stalls by auction;
 - (b) to identify loopholes, if any, that open up opportunities for abuse; and
 - (c) to suggest measures for preventing abuse.

Award of Tenancy

4. Under section 6 of the Public Markets Regulation, Cap. 132, the Director of Food and Environmental Hygiene (“DFEH”) may let public market stalls at such rent and subject to such terms and conditions as he may determine.

Auction

5. Letting by auction is a long-standing practice. The final bidder is required to take up the tenancy of the stall for a term, usually of three years, by signing an agreement on the spot. He has to pay a deposit (equivalent to one month's rent) and the rent in advance for the quarter in which the tenancy commences (or the remainder of the quarter). In a few markets, rents are paid monthly.

6. This is how members of the public enter into tenancies of public market stalls. However, close relatives of existing tenants may do so through transfer or succession and itinerant hawker licence (IHL) holders through an IHL selection exercise.

Transfer or Succession

7. A tenant may transfer the tenancy to his parents, spouse or children on justifiable grounds such as illness.

8. Upon the death of a tenant, his spouse, offspring or nominated successor may apply for succession to the tenancy.

IHL Selection Exercise

9. It is Government policy to phase out IHL holders not by compulsory deletion, but by natural attrition. To encourage IHL holders to give up their licences, FEHD accords priority in letting public market stalls to those willing to surrender their licences. All vacated market stalls first go through a two-stage IHL selection exercise. In the first stage, FEHD will collate returns from districts on available market stalls and then conduct a quarterly restricted ballot. Invitation letters are sent to all (around 800) existing IHL holders. Those interested are required to return a ballot form.

10. Naturally, some stalls are more attractive than others. IHL holders entering the ballot may be interested only in these more attractive stalls. Those who fail to draw an early lot may, therefore, not choose at all.

11. The remaining stalls will then enter the second stage of the selection exercise. FEHD will display a list of the stalls for selection by IHL holders on a first-come-first-served basis.

Stalls that remain vacant will be openly auctioned.

12. Arrangements for the IHL selection exercise including collating returns on available stalls, inviting participants and awaiting the next ballot, span over three to five months. Consequently, a stall will not be available for auction again until three to five months after it becomes vacant.

Termination of Tenancy

13. A tenancy normally lasts for three years but may be terminated prematurely by either party. FEHD may do so if a tenant breaches a tenancy condition or commits an offence. Tenants terminated under these circumstances will be banned from bidding for public market stalls for one year.

14. Tenants who fail to settle outstanding rents also breach tenancy conditions. FEHD may terminate their tenancies and not accept their bids until the rent in arrears has been paid.

15. FEHD exercises its power of terminating tenancies with care. A serious breach (such as selling meat not supplied by approved source) will lead to immediate termination. Otherwise, only breach repeated over a period of time will result in premature termination.

16. A tenant may terminate the tenancy prematurely by giving one-month written notice. No reason is required and there is no minimum period within which the tenancy cannot be terminated without penalty. In such case, the tenant pays rent for one month, leaves upon expiry of notice, gets back the one-month deposit and any unexpended rent. The stall is then left vacant.

17. Failure to give notice to quit will result in forfeiture of the deposit. However, the tenant may still be refunded the unexpended rent. Again, this will cost him a sum equivalent to only one month's rent.

18. All stalls vacated will become available for the next two-stage IHL selection process and auction. This usually means a gap of three to five months.

19. In other words, the current system for termination of tenancy allows an existing tenant to "excise" a nearby stall from competition for up to six months at just one month's rent.

Case Studies

20. To check if there have been instances of irregularity, we examined cases where tenancies were terminated shortly after commencement. We found that since 2001, there had been 213 cases of tenancy being terminated within 12 weeks. We have identified and studied some suspect cases which involved three bidders.

Observations and Opinions

21. We see auctioning as a fair and open means for opening up business opportunities in public markets. At the same time, it maximises public revenue. Regrettably, the FEHD procedures have loopholes for unethical elements to advance their self interests, causing inequity to competitors and to patrons of public markets.

Award of Tenancy

22. Due to the need for giving priority to IHL holders, a stall becoming vacant will not be available for auction for months. This in effect means depriving prospective competitors of business opportunities and denying patrons a fuller choice of goods. It also results in less revenue for the public purse.

23. We accept the policy for priority to IHL holders. However, we see room for improvement in the arrangements. FEHD should cut considerably the time for processing a vacated stall to be auctioned. It should not need to take three to five months (para. 12).

24. By natural attrition, the number of IHL holders decreases with the passage of time. Eventually, there will be few remaining IHL holders, who may not be interested in trading in their licences for tenancies of public market stalls. FEHD should, therefore, review the return rate of ballot forms and consider when it will be appropriate to revise the policy for priority to IHL holders. It may, for instance, consider placing the onus on the IHL holders to indicate interest in trading in their licences.

Termination of Tenancy

25. A tenancy binds FEHD for three years unless the tenant is found to have breached tenancy conditions or committed an offence (para. 13). However, it makes it easy for the tenant to quit (para. 16): the tenant need not justify premature termination and there is no penalty to deter wilful termination. This is not a fair balance of all the interests concerned: prospective bidders, market patrons and FEHD/Government. Furthermore, it breeds abuse. A tenant can drive competitors away for up to six months at a cost of only one month's rent (para. 19).

26. FEHD should, therefore, set a minimum period in the tenancy agreement for market stalls during which termination will attract a penalty payment. To allow flexibility, FEHD should review from time to time the need to provide for genuine exceptional circumstances under which a tenancy may be terminated prematurely without penalty payment. This should deter *mala fide* bidding.

27. FEHD should pay particular attention to cases of early termination, whether within or after the minimum period, and keep proper records for reference.

Notice of Termination

28. FEHD should consider requiring a larger deposit or longer notice for premature termination. This would further increase the cost of early termination and should deter abuse. To shorten the period of vacancy, FEHD should also activate the relevant procedures (para. 12) as soon as notice is received.

Ban on Bidders

29. FEHD should impose restrictions in future auctions on tenants who terminate their tenancies early, as it does for tenants who have breached tenancy conditions or committed offences (paras. 13 to 15).

Recommendations

30. The cases examined show that abuse in auctioning for market stalls should have become evident much earlier. We are surprised that other than a single attempt to tackle a case of blatant abuse, FEHD has not formulated any strategy or action plan to plug loopholes in the procedures or to tighten control over the system.

31. Against this background, unethical bidders have taken unfair advantage of the rules laid down by FEHD. It is imperative that FEHD review the arrangements and procedures for auctioning public market stalls.

32. The Ombudsman has made the following recommendations to the Director of Food and Environmental Hygiene:

(a) Award of Tenancy

- i) in anticipation of the natural attrition of remaining IHL holders, review the return rate of ballot forms: para. 24;
- ii) consider when it will be appropriate to revise the policy for priority to IHL holders in the selection of vacant market stalls: para. 24;

- iii) cut considerably the lead time for preparing for auctions of vacant stalls: paras. 22 to 23;

(b) Termination of Tenancy

Minimum Period

- i) review the terms of the tenancy agreement to set a minimum period, within which tenancies could be terminated only on a penalty payment: paras. 25 to 26;
- ii) inform bidders of such minimum period and penalty payment for early termination: paras. 26 to 27;
- iii) to allow flexibility, review from time to time the need to provide for genuine exceptional circumstances under which a tenancy may be terminated prematurely without penalty payment: para. 26;
- iv) keep proper records on tenants who have applied for premature termination: para. 27;
- v) review the period for longer notice of termination: para. 28;
- vi) review the deposit for a larger amount: para. 28;

Ban on Bidders

- vii) establish mechanism to impose restrictions in future auctions on tenants who have previously applied for premature termination: para. 29; and
- viii) consider sanctions on bidders found to have abused the system in our case studies: para. 29.

Comments from FEHD

33. FEHD has accepted our recommendations. Implementation of some of them is already underway.

Final Remarks from The Ombudsman

34. The Ombudsman is grateful for FEHD's cooperation throughout the investigation, the prompt and positive response to our findings and the readiness to implement our recommendations. She thanks DFEH and his staff for their assistance in the study.

Office of The Ombudsman

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