Know-How

Default and Remedies

1. Summary

1.1 **Remedies under common law and statute.** A landlord has certain remedies under statute and common law for the tenant's breach of its lease. These are termination, damages, and injunction for specific performance. In general, if a breach gives rise to a right of termination, the landlord has an essential choice – to keep the lease in existence or terminate it (known as 'forfeiture' or 're-entry')

1.2 **Remedies if the landlord elects not to terminate.** If the landlord elects to keep the lease in existence, its remedies will depend upon the obligation that has been breached and the overall circumstances. Its remedies will include:

(a) switching off the utilities serving the premises;

(b) remedying certain breaches itself such as want or repairs or illegal alterations and claiming the costs from the tenant;

(c) deducting the Loss suffered from any deposit or claiming under the bank guarantee provided in lieu of a deposit and requiring the deposit to be topped up or a further bank guarantee to be delivered, or claiming under any third party guarantee;

(d) suing for recovery of sums due, including rent, as a debt;

(e) suing for damages;

(f) asking for payment under indemnity;

(g) charging default interest on overdue amounts;

(h) pursuing court action called "distress for rent" where the tenant's chattels on the premises are seized and sold to pay unpaid rent and rates; and

(i) seeking an order for specific performance or a negative injunction.

1.3 **Right to terminate and ancillary remedies.** If the landlord elects to terminate the lease, it may do so by court action or by peaceable physical re-entry of a part of the premises (there is no need to possess the whole). In this case the landlord's additional remedies will include:

(a) remedying certain breaches itself, such as want of repair, illegal alterations or reinstating the premises, and claiming the costs from the tenant;

(b) deducting the Loss suffered from any Deposit and claiming under any Bank Guarantee or third party guarantee;

(c) suing for recovery of sums due, including rent up to the date of termination, as a debt;

(d) in the case only of a repudiatory breach, claim for its lost rent for the "unexpired term" of the lease, provided that the landlord seeks to mitigate the harm by seeking a new tenant at a reasonable rent;

Version: 27 November 2023

(e) charging default interest on overdue amounts; and

(f) selling any tenant's chattels left on the premises.

1.4 **Failure to vacate.** If the tenant fails to vacate the premises after the expiration or termination of the Term, the landlord may also claim claiming *mesne profits*, which is a tort remedy that compensates the landlord for the wrongful occupier's trespass. The measure of compensation is the value to the trespasser of occupying the premises and extracting value from the landlord's property. In general, that is the then market rent of the premises, [but it can also be calculated as the trespasser's profits attributable to its use of the premises].[1] The landlord may also have a claim for damages for the tenant's breach of covenant that arose before termination such as a breach of the tenant's covenant to deliver up the premises.

1.5 **Events giving rise to a right of forfeiture.**

(a) To be completed once the drafting is done. Some of the intricacies are in the insolvency section – note on insolvency. I've left the following para in relation to the s.58 notices divide mentioned in your notes to the lease.

(b) Under the Standard Lease the landlord may forfeit the lease in any of the following events:

(i) 7 days' arrears in payment of rent or other amounts owing under the lease;

(ii) the tenant's breach of any other obligation under the lease;

(iii) Commencement of bankruptcy or winding up of the tenant;

(iv) Dissolution or incapacity of the tenant; and

(v) Certain other events that may indicate that the tenant is in financial difficulty;

(c) In negotiating a lease, items (b)(i) to (b)(iv) should always be included in the *Default* section (clause __ of the Standard Lease). The additional events in the Standard Lease giving the landlord a right to forfeit are

(i) Events, short of formal winding up, that may (or may not) indicate that the tenant's financial affairs are distressed (see part 4.1 below);

(ii) events that may change the tenant's controlling person or persons; and

(iii) [Others.]

(d) Prospective tenants may object to some or all of the events of default mentioned in 1.6(c). They may argue, for example, that events short of commencement of a winding up should be of no relevance to the landlord so long as payments are current under the lease; but the landlord may want the right to exercise remedies prior to formal commencement of a winding up. (See discussion in part 4 of this note.). For some tenants, a change in owners or controlling parties is not important, as the landlord does not care about tenant's ownership or because the tenant is a widely held public company with no controlling owners.

[1] In theory it could be less than or greater than the former rent.

2. Landlord remedies under the Standard Lease where the landlord has elected not to forfeit the lease.

2.1 **Switching off the utilities serving the premises.** This remedy is provided for in the Standard Lease and is not available at common law or by statute, so the landlord will not have this right if the clause is removed.

Whilst there is no regulatory prohibition on cutting off electricity or water supply, there may be other consequences. If the tenant becomes unable to use the premises due to the lack of lighting, heating, air conditioning, etc. the tenant may have claims against the landlord for derogation from the grant originally made by the landlord or for breach of the landlord's covenant of quiet enjoyment. The landlord may also incur tortious liability if cutting of utilities creates health and safety issues.

2.2 **Remedying certain breaches itself such as want of repair or illegal alterations and claiming the costs from the tenant.** The Standard Lease contains express covenants allowing the landlord to enter the premises to remedy any breach of covenant. While the landlord has an implied right in law to enter the premises to do repairs for which it is responsible, it has no such implied right where the tenant is responsible, so the landlord would not have this "self-help" remedy if these covenants are removed from the lease.

2.3 **Deducting the Loss suffered from any Deposit and requiring the Deposit to be topped up or claiming under any third party guarantee or Bank Guarantee and requiring a further Bank Guarantee to be delivered.**

(a) The right to deduct from a deposit or claim under a bank guarantee provided in lieu of a deposit is a contractual right, not one implied by law. The lease must specify how the deposit or bank guarantee may be used, and the language of the guarantee should reflect that.

(b) The Standard Lease does <u>not</u> provide that the entire deposit or bank guarantee can be forfeit as liquidated damages, so only the amount owing from the tenant can be deducted or demanded. This is because liquidated damages are an exclusive remedy, and landlords do not want to limit their recovery to the amount of the deposit or bank guarantee when, in many cases, the loss will exceed the amount of the deposit or bank guarantee.

2.4 **Suing for recovery of sums due, including rent, as a debt.**

(a) Processes to sue on a debt are often quicker and simpler than suits for damages.

(b) When a creditor seeks repayment of an unpaid debt, it does not have to prove that it attempted to mitigate its damages.

(c) To be recoverable as a debt, amounts must be ascertainable without further agreement between the parties.

(d) The Standard Lease provides that the following can be recovered as debts if not paid when due:

(i) rent

(ii) the landlord's and manager's costs relating to works and other things done by or for the tenant;

(iii) the landlord's costs related to waivers or consents;

(iv) the landlord's costs in adding the tenant's name to signage;

(v) the landlord's costs in returning premises to the required condition at the end of the lease;

(vi) the landlord's costs incidental to distress for rent; and

(vii) valuer's fees in connection with a rent review.

2.5 **Suing for damages.**

(a) The right to sue for damages is inherent in all contracts at common law.

(b) The landlord must demonstrate that the damages flowed from the tenant's non-performance.

(c) The landlord must show that it has made reasonable efforts to mitigate its damages.

2.6 **Charging default interest on overdue amounts.** Interest will not be void as a penalty where it is not extreme. This would likely be considered in the context of the prime lending rate and the court rate of interest for the time being. There is no certainty on what level of default interest would be considered "extreme", but courts have supported rates of prime plus 3%.

2.7 **Pursuing court action called "distress for rent".**

(a) This is a court action where the tenant's chattels on the premises are seized by a bailiff and sold to pay unpaid rent or government rates.

(b) Rent in Hong Kong does not include management fees for the purpose of distress for rent. Management fees can be distinguished from rent – they are not fixed amounts issuing out of the land but a payment for maintenance services rendered for the benefit of all occupiers. This has the result that even if a lease describes the management fees as rent, the remedy of distress is not available to recover unpaid management fees. In the case of multi-owned buildings, distress is available as a remedy for non-payment of management fees to an owners' corporation under Section 24 of the Building Management Ordinance (Cap___). If an owner has not paid these amounts, the owners corporation can seek to recover them from the occupier but only to the extent that the occupier is in arrears of rent and other charges due (excluding rates). This would require authorisation, usually by a resolution, of the owners' corporation.

(c) A landlord may not use self-help here: it must apply to a court: and the landlord will be liable for fines or imprisonment if it attempts to seize a defaulting tenant's goods other than through the prescribed court procure. This would be the case even if a lease specifically gave the landlord that authority.

(i) A landlord could also be liable if a court determines that the landlord had no reason to believe that the property was properly distrainable.

(ii) The Standard Lease provides that rent, management charges and rates can be distrained for.

(iii) There is no right to distrain for *mesne profits* (the compensation that a person holding over after termination of its leasehold interest owes to a landlord for

occupation of the premises), so a landlord that has forfeited a lease, cannot distrain for "rent" against a person holding over for amounts falling due as *mesne profits* after the forfeiture date.

2.8 **Seeking a court order for specific performance or an injunction.**

(a) A court can issue either a negative injunction, ordering a tenant not to do something, such as to stop a non-permitted use of the premises, or an affirmative order for specific performance requiring a tenant to do something it is required to do, such as to make repairs.

(b) Specific performance and injunctions are equitable remedies, so they can be granted or withheld in the discretion of the court and they can be crafted as the court sees fit.

3. Landlord's rights and restrictions in forfeiture

3.1 **Restrictions on how the landlord exercises its forfeiture right.**

(a) Under the Standard Lease, the landlord may exercise the forfeiture right by:

(i) seeking a court order for forfeiture;

(ii) peaceably physically re-entering part of the premises; or

(iii) posting a forfeiture notice on an entrance to the premises.

(b) There are strict legal limitations on the landlord's actions in the forfeiture process, and the forfeiture may be ineffective, or the landlord may incur civil or criminal liability if it fails to follow proper processes. The key restrictions, discussed further in the sections below, are:

(i) If the landlord re-enters other than by court process, it must do so peaceably;

(ii) If the landlord re-enters for reasons other than non-payment of rent, bankruptcy of the tenant or "taking in execution of the lessee's interest", it must first follow carefully the notice process set out in Section 58 of the Conveyancing and Property Ordinance; and

(iii) If the landlord seeks to re-enter when the tenant is in liquidation (if a company) or bankrupt (if an individual), there are prohibitions on taking action and other restrictions under the law governing winding up and bankruptcy.

(c)

(d) Landlords may incur criminal liability under the Public Order Ordinance (Cap 245) if they re-enter premises physically and the re-entry is not peaceable, so a landlord must exercise extreme caution in physically re-entering premises[2].

(i) There is no strict definition of peaceable re-entry, but physical re-entry may be non-peaceable if there is anyone inside the premises or if the landlord re-enters in a way that damages property.

[2] There are additional protections for residential property. This note only covers non-residential leases.

(ii) The Standard Lease provides that re-entry can be effected by posting a notice without physically re-entering the premises. Changing locks on non-residential premises, provided nobody is inside, will generally be considered a peaceable method of physical re-entry.

(e) Regardless of whether re-entry is to be by court order, physical re-entry or posting a notice, where the reason for re-entry is not non-payment of rent (which may include certain amounts other than rent alone), bankruptcy or winding up of the tenant or execution upon the lessee's leasehold interest, the landlord must first deliver a "section 58 notice" to the tenant.

(i) The notice must comply with Section 58 of the Conveyancing and Property Ordinance (Cap 219) (**CPO**) and must describe the breach and either give the tenant a reasonable time to remedy the breach or set out the landlord's reasons for determining that no cure period will be provided because the breach is not capable of remedy within a reasonable period.

(ii) Caution should be exercised in determining that a breach is not remediable. Courts will decide independently if the breach was remediable, and the landlord's notice will be ineffective if the court decides that the tenant should have been given an opportunity to cure the breach.

(f) Winding-up of the tenant creates particular complications in enforcing a landlord's right of forfeiture (or exercising other remedies), as actions against a company that has commenced winding-up may require permission of the court or will otherwise be delayed to allow for orderly liquidation and winding up procedures. See further details in part [4] below.

3.2 **The tenant has rights to seek relief from forfeiture.**

(a) A court can grant the tenant "relief from forfeiture", that is it can issue a court order that stops the landlord from exercising its legal right of forfeiture because of considerations of equity (fairness).

(i) Hong Kong statutory law or common law principles of equity provide avenues for tenants to apply for relief from forfeiture in most circumstances.

(ii) There is no statutory provision for relief where forfeiture is for the tenant's bankruptcy or winding up, although a sub-tenant may apply to the court for relief when the reason for forfeiture was the head-tenant's winding up or where no relief is granted to the head-tenant for non-payment of rent.

(b) As relief from forfeiture is an equitable procedure, the court has broad discretion to grant or withhold relief in consideration of all the facts and circumstances and to grant relief only on certain conditions as the court considers appropriate.

(i) A court can consider both the landlord's and the tenant's actions and circumstances, among other things.

(ii) The court's discretion not to grant relief is constrained where the only cause for forfeiture is non-payment of rent - Section 21 of the High Court Ordinance has been interpreted to require the court to give a defaulting tenant an opportunity

to pay the arrears (and the landlord's costs in the action), but this applies only once in the term of a lease.

(c) Where a court grants relief, it will generally do so on the condition that the defaulting tenant must first pay any arrears, remedy any other breaches and pay the landlord's costs in bringing the claim, but the court can make such orders as it sees fit.

3.3 **The landlord must elect to forfeit or to exercise other remedies without forfeiting.**

(a) If a landlord is aware of a breach and wants to forfeit the lease, it must not to do an "unequivocal act" that recognizes the lease as continuing. Unless the breach is classified as a continuing breach (see paragraph 3.3(d) below), if the landlord does such an act, it will have been deemed to have waived its forfeiture right, and this waiver is irrevocable.

(b) Where a representative or agent of the landlord, including a manager appointed by the landlord, is aware of a breach, the landlord may be considered to be aware.

(c) Accepting or pursuing rent that falls due after the landlord has knowledge of the breach generally will be found to constitute a waiver of the landlord's right to forfeit for that breach, and it is unlikely that the law can be overridden by contractual provisions saying that the landlord's actions will not constitute a waiver.

(i) A clause in a lease that says that the landlord's acceptance of rent after a breach will not be a waiver is likely to be ineffective (this is not in the Standard Lease).

(ii) The Standard Lease does however specify language that a simple delay in exercising a remedy does not, by itself, waive the breach.

(d) However, certain breaches are considered to be "continuing"; i.e. they recur constantly until they are remedied. Examples are failure to repair or violation of a use restriction.

(i) Continuing breaches will not be considered to have been waived by a landlord's act such as accepting rent.

(ii) However, there are some cases where a continuing breach is of such magnitude that a landlord, knowing of the breach and appearing to acquiesce in it, has been determined to have waived the breached covenant "once and for all". In *Chinachem Investment v. Chung Wah Weaving*[3], where a landlord not only knew of, but appeared to have encouraged, a long-standing change in use from warehouse to manufacturing that would have been costly to undo, the court held that the landlord had waived the continuing breach until the end of the lease term.

4. Damages

4.1 **Inherent common law remedy of damages.**

[3] [1978] HKCU 14 (HK, Court of Appeal)

(a) Either the landlord or tenant may entitled to contractual damages. Contractual damages are assessed on the basis that the non-defaulting party should be put in the same position as if the contract had been performed[4].

(b) Damages can fall into two types[5]:

(i) Direct loss: loss which may fairly and reasonably be considered as arising naturally from the breach, in the ordinary course of things.

(ii) Indirect or consequential loss: loss which may reasonably be supposed to have been in the contemplation of both parties at the time they made the contract, as the probable result of its breach.

(c) The second type has been considered in numerous cases, particularly in the context of exclusion of claims for indirect loss. Financial losses, including loss of profit may well fall within type 1 as loss which one would normally expect to flow from the breach. Any exclusion of liability for certain types of financial loss should be expressly stated rather than loosely subsumed in a general reference to 'indirect loss'. The intent of an exclusion will be construed in the context of the contract as a whole and the factual matrix.

(d) Landlord is subject to duty of mitigation to minimize its loss by taking steps to restore and relet the premises expeditiously[6]. Landlord cannot claim for loss that can be reasonably avoided or if landlord's costs in remedying tenant's breach are disproportionate to the benefit obtained[7].

4.2 **Liquidated and unliquidated damages**

(a) Generally, there are two types of damages:

(i) Liquidated damages: a fixed or ascertainable sum of damages recoverable for a specific breach of contract[8]. The parties can agree on the specific amount to compensate certain types of breach and put it in the form of liquidated damages clause in the agreement.

(ii) Unliquidated damages: a claim for an amount of damages suffered by the innocent party assessed by the court based on both parties' conduct and relevant facts. This remedy is always available for the innocent party to claim for the actual loss suffered due to the other party's default even when the contract does not expressly provide for it.

(b) The "damages" mentioned in this note is usually referring to unliquidated damages, which is of uncertain amount pending for court's assessment of actual loss suffered by the innocent party. Under common law, only unliquidated damages that is not too

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[4] *Hadley v Baxendale* [1843-60] All ER Rep 461 (Court of Exchequer, E&W)

[5] *Hadley v Baxendale* (ibid)

[6] Tennyson Estate Ltd v Wu Shao Zhang (unreported, HCA 227/2001, 5 November 2003) (Court of Appeal, HK)

[7] Sunlife Europe Properties Ltd v Tiger Aspect Holdings Ltd [2013] EWHC 463 (Technology and Construction Court, E&W): if landlord carries out more extensive work than was caused by tenant's breach allows the landlord to recover that part which is the cost of the work done to remedy the breach

[8] Hang Seng Finance Ltd v Lin Kwok Man [1991] 2 HKC 613 (Hight Court, HK)

remote and is limited by prompt mitigating measures adopted by innocent's party can be recovered.

(c) The liquidated damages is an agreed amount of damages which is certain and fixed. It is enforceable when it is not a penalty clause according to the test in Cavendish Square Holding BV v Talal El Makdessi and ParkingEye Ltd v Beavis[9] (**Cavendish**): the clause is a penalty if it is concerned with a secondary obligation which imposes detriment on the default party out of all proportion of any legitimate interest of the innocent party in enforcing the primary obligation. The common law rules remoteness and duty to mitigation are not applicable if the liquidated damages clause is valid and enforceable.

4.3 **Common examples of damages claimed by landlord.**

(a) Breach of alteration, repairing and yielding-up covenants.

Action for damages during term of lease	**Action of damages after determination of lease**
Amount of damages: • The damages are usually the amount why which saleable value of the premises has been reduced by non-repair of the premises[10]. • If the damages are claimed during the subsistence of the term, the reduced amount depends upon the length of unexpired term[11]. • If landlord elects to forfeit due to the breach, the damages are assessed as if the term had expired, there is no reduction in the recoverable age damages[12].	Amount of damages: • The damages are usually the amount landlord takes to repair the premises left by tenant. • The amount should be actual cost carrying out such repair which is necessary to remedy the breach[13] if it is reasonable for landlord to do so[14]. • The compensation for failure to reinstate the premises should be fair and proportionate to the benefit to be incurred[15]. • A sum of loss of rent during the time of repairing premises[16]. No award of damage of cost: • Landlord has no intention of carrying out: when the premises are to be demolished or altered which render the repairs valueless, or to be sold or let to others who will repair the premises to their own requirement immediately after the expiry of lease term[17].

(b) Breach of alienation covenant.

[9] [2016] 2 AII ER 519 (Supreme Court, UK)

[10] Smith v Peat (1853) 9 Exch 161 (E&W)

[11] Turner v Lamb (1845) 14 M & W 412 (Court of Exchequer, E&W)

[12] Hanson v Newman [1934] Ch 298 (Court of Appeal, Eng): the proper measure of damages is the difference in value between the premises as they are at the time of the re-entry and the value of the premises when there is no breach of covenant during the term.

[13] Sunlife Europe Properties Ltd v Tiger Aspect Holdings Ltd [2013] EWHC 463 (Technology and Construction Court, E&W)

[14] Latimer v Carney [2006] EWCA Civ 1417 (Court of Appeal, E&W)

[15] Liu Hong Keung v Liu Ching Leung [2006] HKCU 378 (Court of First Instance, HK)

[16] Culworth Estates Ltd v Society of Licensed Victuallers (1991) 61 P & CR 211 (Court of Appeal, E&W)

[17] Latimer v Carney [2006] EWCA Civ 1417 (Court of Appeal, E&W): when the premises are to be demolished or altered immediately after end of the lease, which would render the repairs valueless or are to be sold or let to others who will repair

(i) If landlord sues for damages, it will be measured by the loss naturally flowing from the assignment or underletting[18]. For example, if the premises are destroyed because of special risk attaching to the purpose for subletting, the damages will be the loss caused[19].

(ii) Also, the breach may be restrained by injunction[20].

4.4 **Landlord's considerations.**

(a) Take prompt actions to reduce loss. Since landlord has duty of mitigation, landlord should try to reduce its loss by repairing the promises at reasonable price and reletting the premises as soon as possible. When the market is good with high demand, landlord's reasonable mitigation should be re-letting the premises at market rent as soon as possible.

(b) Whether landlord can claim for loss of future rental income or "loss of bargain"?

(i) To sue only for the arrears of rent up to the date of determination, but also loss of the future benefits under the lease that landlord would have enjoyed the lease gone full term, landlord must show tenant's breached covenant is a fundamental or essential term that give rise to repudiation of lease[21].

(ii) Since there is usually debate over the second limb of damages in the Hadley v Baxendale, the indirect or consequential loss, and the case law is less clear on its assessment, landlord usually includes a provision in lease to cover "loss of bargain damages" if lease is terminated early as the result of tenant's default.

(iii) To enforce this clause, landlord must provide evidence of its reasonable and appropriate attempt to re-let the premises. Only if landlord fails to relet the premises or the premises can only be re-let for a lesser amount than the amount stipulated in the terminated lease, landlord can enforce the provision to seek loss of bargain damages[22].

5. Indemnity

5.1 **What is an indemnity?**

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[18] Cohen v Popular Restaurants Ltd [1917] 1 KB 480 (Queen's Bench Division, E&W): When made by an assignee, the assignment puts an end to his liability on the covenants in the lease; and, if it is made to one of inferior pecuniary liability, the measure of damages will be such a sum as would, as far as money can, put the landlord in the same position as if he still had the original assignee's liability for breaches of covenant, past and future

[19] Lepla v Rogers [1893] 1 QB 31 (Queen's Bench Division, E&W)

[20] Esso Petroleum Co Ltd v Kingswood Motors (Addlestone) Ltd [1974] QB 142 (Queen's Bench Division, E&W): court ordered the assignee to reassign the lease

[21] Shevill v Builders Licensing Board (1982) 149 CLR 620 (High Court of Australia)

[22] Gigi Entertainment Pty Ltd v Schmidt [2013] NSWCA 287 (Court of Appeal, NSW): landlord re-entered the premises when tenant breached the essential term to pay rent on time. After getting the possession of the premises, landlord carried on the hotel business conducted by tenant before but operated the hotel at a loss. Landlord's appeal was rejected since the court found that landlord was not obliged to assume the conduct of hotel business on termination of lease, and there was no evidence that landlord had no option but to operate hotel business, nor evidence of landlord attempted to relet the premises.

(a) Indemnity is an express obligation imposed on the offering party to pay monetary compensation to the receiving party for the loss and damage on the happening of a specified event or the offering party's breach of contract.

(b) There are generally two types of indemnities:

(i) Indemnity arising by operation of law;

(ii) Contract of indemnity: an indemnity clause in the contract under which the offering party promises to pay the receiving party on happening of a specified event or the offering party's breach of contract.

(c) There are two essential components which should be clearly defined to make sure an indemnity clause is clear and sufficient to provide intended protection because any ambiguity in contract will be interpreted strictly against receiving party (**ejusdem generis rule**)[23]:

(i) Trigger: the situation or event which triggers the offering payment's payment obligation, and

(ii) Payment: the way landlord can receive payment from tenant.

5.2 **Considerations in drafting an indemnity clause.** Following issues are usually debated which landlord should be aware of and take into consideration when it is drafting and negotiating an indemnity clause.

(a) Can indemnity give 100% recovery?

(i) Usually when landlord asks to an indemnity given by tenant, landlord is intending a dollar-to-dollar compensation from tenant. In contrast, in common law, landlord's remedy of damages will be subject to rule of remoteness and duty to mitigate, where only foreseeable loss or loss in reasonable contemplation of both parties is recoverable in claim for damages if landlord has taken prompt measure to reduce its loss[24].

(ii) However, in an English Court of Appeal case Total Transport Corp v Arcadia Petroleum Ltd (**The Eurus**)[25], the Court confirmed that the extent of offering party's liability under an indemnity depends on the nature and terms of contract, as well as its own facts and circumstances. Where the indemnity clause in The Eurus is so broad which was drafted against "all loss" caused by a breach, the Court held the indemnity was subject to rule of remoteness and receiving party could only recover the loss which was foreseeable or in reasonable contemplation of both parties. 100% recovery may not be possible as the result of poor drafting of indemnity clause.

(iii) To reduce the risk of landlord's loss being irrecoverable due to common law rules when tenant commits any breach, landlord is advised to specify types of

[23] Multiplex Construction Europe Ltd v Dunne [2017] EWHC 3073 (Technology and Construction Court, E&W)

[24] Hadley v Baxendale [1843-60] All ER Rep 461 (Court of Exchequer, E&W)

[25] [1998] 1 Lloyd's Rep 351

loss that are likely to be suffered and expressly exclude the application of rule of remoteness and duty to mitigate in indemnity clause.

(b) Does indemnity cover receiving party's negligence?

(i) Indemnity may not cover losses of receiving party's failure to take reasonable care upon occurrence of trigger event unless the clause is drafted to include expressly receiving party's own negligence or fault[26].

(c) Is the trigger for liability sufficiently defined?

(i) As mentioned, indemnity clause may be strictly interpreted against receiving party, and so trigger in indemnity may be under strict scrutiny to narrow its scope. In the case of Wood v Capita Insurance Service Ltd[27], when the buyer discovered mis-selling and reported to the regulatory authority to perform its regulatory obligation, it failed to claim its £1.35 million compensation to customers relying on the indemnity with description "following and arising out of claims or complaints…". Court of Appeal held that the loss was not following or arising out of any claim or complaint, and did not save the buyer from a bad bargain by interpreting the indemnity clause.

(ii) Since tenant's payment obligation only arises when trigger event happens, if the trigger is broadly described as breach of contract or tenant's duty, landlord needs to anticipate and expressly include what breaches can trigger payment of indemnity, and whether fault by either party should be set as part of the trigger to save the trigger from strict interpretation.

(d) Must the loss be caused by the trigger?

(i) Whether causal link is needed between landlord's loss and trigger event depends on the wording.

(ii) "In connection with" may be a wide phrase, which was held to entitle receiving party to recover losses not actually caused by the trigger but connected with it in some other ways[28].

(iii) Where an indemnity is against losses following a breach of contract, "[losses] arising out of or in connection with [the breach]" included the consequences of the breach[29].

(e) Can indemnity cover all losses?

(i) There is risk of uncertain interpretation when the clause contains general descriptions of "all loss", "all sums payable", "all liabilities incurred" and "including without limitation to".

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[26] Onego Shipping & Chartering BV v JSC Arcadia Shipping, The Socol 3 [2010] All ER (D) 179 (Apr) (Commercial Court, E&W)

[27] [2017] UKSC 24

[28] Campbell v Conoco (UK) Ltd [2002] EWCA Civ 704 (Court of Appeal, E&W)

[29] Scipion Active Trading Fund v Vallis Group Ltd [2020] EWHC 1451 (Comm) (Commercial Court, E&W)

(f) The only thing landlord can do is to think about all possible breaches or damages it concerns most about and list them out specifically in additional to general description. Also, landlord should expressly exclude application of any unfavourable rules, including remoteness of damages, duty to mitigate, and ejusdem generis interpretation rule.

5.3 **Negotiation of a broad indemnity.**

(a) Lease will usually contain an indemnity given by tenant to landlord to indemnify against all liabilities, expenses, costs, claims, damages and losses in relation to specified events, or any breach of any tenant's covenant in the lease.

(b) tenant is usually concerned over indemnity because it imposes a strong and arbitrary obligation which tenant wishes to avoid. If indemnity is to be included, tenant may wish to impose as many conditions or limits as possible to limit its responsibility.

(c) How indemnity clause is negotiated depends on bargaining power of both parties:

(i) If tenant has strong bargaining power, it may argue to delete indemnity clause on the basis that landlord is already having sufficient protection by other covenants and other types of remedies, such as claim for damages and forfeiture.

(ii) If landlord is strong bargaining power and insists on inserting indemnity clause in the lease, tenant may wish to amend the clause in following manners:

(A) Adding part to give tenant some control over the conduct of third party claim which tenant is to indemnify landlord;

(B) Specifying the procedures and receipt which landlord must follow;

(C) Imposing a duty to mitigate the loss using all reasonable endeavours on landlord;

(D) Imposing a cap on the amount of indemnity;

(E) Limiting the indemnity payable only on breach of tenant's fault; and

(F) Limiting the extent of indemnity to cover the losses that are not covered by the insurance.

(d) There is an indemnities clause in Standard Lease [clause 6.6] which set out tenant's payment obligation to cover all loss and costs on demand in connection to following trigger events:

(i) the recovery of rent and any other monies if not paid as and when due from tenant;

(ii) any breach of lease by including anything landlord does as a consequence thereof;

(iii) the exercise, consideration of the exercise or attempt to exercise any rights following the tenant's breach;

(iv) any loss suffered due to termination of lease arising from tenant's breach, including loss of rent, management charges, and other amounts due from tenant under this lease for duration of complete term;

(v) anything occurring at the premises or from the state of repair and condition of the premises; and

(vi) the spread of fire, smoke, water or any other substance, or contamination from the premises.

6. Winding Up

6.1 **Events of Default related to tenant winding up under Standard Lease.** The Standard Lease addresses the following situations where the landlord may forfeit the lease because of a tenant's financial distress or winding up:

(a) The tenant becomes bankrupt, which applies only to individuals;

(b) The tenant commences winding up, which refers to any of the situations described in paragraph 4.3 below, and the following specific commencement actions are specified:

(i) the tenant passes any resolution of its members or directors for winding up;

(ii) a petition is filed with the court for the tenant's winding up or bankruptcy;

(c) The tenant is unable, or admits its inability, to pay its debts as they fall due or is otherwise insolvent. Inability to pay debts can be a reason for the commencement of a voluntary or involuntary winding up, but does not itself commence a winding up. The reference to "otherwise insolvent" is added as it is a broader concept than "unable to pay debts as they become due", as "insolvency" may include "balance sheet" insolvency (debts greater than assets) and possibly other measures of insolvency.

(d) The tenant appoints or there is appointed for it a liquidator (provisional or otherwise). Appointment of a liquidator does not, by itself, commence a winding up under Hong Kong law, however appointment generally will occur after a winding up has commenced. In most circumstances, therefore, this provision will not give the landlord an additional forfeiture right. However, a company could appoint a liquidator or accept a liquidator nominated by creditors and commence actual liquidation prior to commencing winding up formally. Also, the court can, in special circumstances, appoint a liquidator before a winding up petition is filed.

(e) A receiver is appointed for the tenant or its property. – Debentures, mortgages and certain other instruments usually give the creditor the right to appoint a receiver for the assets of the company that are charged to secure the obligation when the obligation is not being fully performed. In the case of debentures, this is often all of the assets and undertaking of the company. The right to appoint a receiver is a contractual right and does not need to be exercised through the courts. This is not a winding up event per se, but it very often will lead to or be simultaneous with a winding up.

(f) The tenant enters into or attempts to enter into a scheme of arrangement with its creditors. A company may enter into an "arrangement or compromise" with creditors under s. 669(a) of the Companies Ordinance (Cap 622). This is a court action where the court summons creditors to meet and attempt to agree on a plan for the company to meets its obligations. Where enough of the creditors accept a plan, the court can make it binding on all creditors. A scheme of arrangement is often undertaken in an attempt

by both the company and its creditors to avoid a winding up. The landlord will not be barred from taking action to forfeit the lease while the company and its creditors are trying to work out a scheme of arrangement, but the tenant could seek relief from forfeiture in that circumstance, and the court could take into account the company's effort to establish a scheme of arrangement in deciding whether to grant the relief. The landlord will be bound, along with other creditors, from taking action in violation of the scheme of arrangement once it is approved by the court. [30]

6.2 **Types of winding-up.** Under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32) there are different kinds of winding up relevant to corporate tenants:

(a) Voluntary winding up, commenced either by the company, if the company is solvent, or by its creditors (a "creditors' voluntary winding up"), if the company is not solvent; and

(b) Winding up by court order, usually because the company is unable to pay its debts or where winding up is otherwise "just and equitable" in the view of the court[31].

Under Hong Kong Law, personal bankruptcy, which this note does not address, is dealt with under the Bankruptcy Ordinance (Cap 6), which may be relevant if the tenant is an individual or a partnership.

6.3 **Commencing winding-up.** A winding up commences:

(a) in the case of a voluntary winding up by a solvent company, on the passage of a resolution of the members to commence a voluntary winding up[32];

(b) in the case of a creditors' voluntary winding up, on the passage of a resolution of the members or the directors to commence a voluntary winding up, which resolution will also call a meeting of creditors, appoint a provisional liquidator and resolve to deliver a winding up statement to the registrar of companies;

(c) in the case of an application from the Registrar of companies, on the filing of the Registrar's petition with the court;

(d) in the case of a non-voluntary winding up by the court, on the filing of a petition with the court by a person (usually a creditor, but can be others) entitled to file such a petition.[33]

6.4 **Effect of winding-up**

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[30] The Standard Lease reflects Hong Kong terminology, but, as tenants may be present in multiple jurisdictions, it also provides that there is a default if similar things occur to the tenant in other jurisdictions.

[31] Other reasons for involuntary winding up include: the company passes a special resolution for winding up; does not conduct business for a year; or has no members; or there occurs an event for winding up that is specified in the company's articles. The Companies Registrar and SFC also have rights to petition for winding up in some situations.

[32] In the case of members' voluntary winding up, the resolution must be accompanied by a "certificate of solvency" from the directors, where there is no such certificate, the winding up will become a creditors' voluntary winding up, and a creditors' meeting must be held substantially contemporaneously with the resolution pursuant to statutory notice and other requirements.

[33] In a non-voluntary winding up, the winding up commences on the filing of a petition requesting the court to make a winding-up order, but it may take a court some time to act on the petition, which the court may accept or reject. When the court accepts the petition and issues a winding up order, the order "relates back" to the date of the petition, but this creates a "twilight period" between filing of the petition and the order or appointment when it is not known if the company will actually be liquidated or not.

(a) **No dispositions.** After commencement of a non-voluntary winding up, any disposition of the company's property is not permitted except with a court order (the disposition would be void).

(b) **Stay of proceedings.** From the commencement of a winding up (or appointment of a liquidator if earlier) there are restrictions on actions and proceedings being brought against the company:

(i) In a non-voluntary winding up, between the date of the petition and the earlier to occur of the appointment of a liquidator and the issue of a winding up order, proceedings may be commenced against the company, and ongoing proceedings may continue, but the court may suspend ("stay") the proceedings on application from certain classes of persons;

(ii) In a non-voluntary winding up, from the earlier to occur of appointment of a liquidator (provisional or other) and the issue of a winding up order, no proceedings may be brought or continued against the company without the consent of the court;[34]

(iii) In voluntary winding up, there is no automatic stay of either new or continuing proceedings, but the liquidator can seek a court order to prevent or stay any new actions or proceedings or to stay any ongoing actions or proceedings.

This means that, although the landlord has rights to forfeit under the Standard Lease both before and after the commencement of a winding up, the landlord's actions may be delayed or obstructed by application of winding up law if the forfeit action (or any other exercise of remedies under the lease) is not completed by the time a winding up formally commences.

(c) **Return of preferences**. Even where the landlord has completed a forfeit or other exercise of remedies before commencement of winding up, certain payments made by companies before commencement of a winding up[35] could be required to be returned for the benefit of certain classes of creditors, particularly employees and the government, that are given preferential access to the company's assets, and payments made to a creditor may be required to be returned if the court determines that the company unfairly preferred one creditor over another.

(d) **Disclaimer.** The tenant's liquidator has the power to "disclaim" onerous contracts, which could include a lease. An onerous contract is one where the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. If disclaimer is permitted, the court excuses the company from further performance of the onerous contract. If a lease is disclaimed, the landlord will have a claim in the winding up, together with other creditors, for any amounts owing prior to the date of the disclaimer. A lease may be considered "onerous" where it cannot

[34] The stay does not prevent secured creditors executing against secured assets, so the landlord can use the deposit or bank guarantee, but landlords rarely have security beyond the deposit or bank guarantee.

[35] In general, six months prior to the commencement of the winding up, but longer periods are provided where the payment was to a person connected to the company or was for undervalue.

be sold, as is the case with most leases that have anti-alienation covenants. It may also be considered "onerous" where it is used in a loss-making operation or where the premise have been abandoned in whole or part or are underutilized. Generally a lease is not "onerous" simply because the rent is above market.

6.5 **Process for forfeiture after commencement of winding-up.** Where the reason for the forfeiture is that a winding up has been formally commenced (see para 4.3) or that a creditor has executed on the tenant's leasehold interest, no section 58 notice is required before the landlord takes action for forfeiture. (See para 4.4 above re the requirement for court permission to bring a court action for forfeiture during winding up.) The "stay" provisions would not apply to forfeiture by physical re-entry, but the liquidator may still apply to the court to enjoin the re-entry. In the other situations of tenant financial difficulty (other than non-payment of rent) set out in the Default section of the Standard Lease (see paragraph 4.1 above), a section 58 notice will still be required, but the situation will often not be susceptible of cure in a reasonable period. The landlord should consider the particular situation.

6.6 **Relief from forfeiture during winding up may be granted to subtenants.** There is no statutory provision for relief from forfeiture where the tenant is being wound up, and courts are unlikely to grant relief to such tenants under their general powers. Sub-tenants[36], however, may be granted relief where the superior tenant is being wound up. If the court grants relief to a subtenant, it is likely to order that the subtenant take over the remaining term of the head lease.

[36] And, in some circumstances, tenant's licensees (*Hindcastle Limited*) [mortgagees][or others with an interest in the [leasehold][premises].