Chapter 3

Preliminaries to the lease

Capacity

A preliminary question is whether the intending landlord and tenant respectively have capacity (the ability in law) to make and take leases. The general rule is that any person not under any personal disability has power to grant and take a lease.

Aliens (but not enemy aliens) are included in this general rule: the Aliens (Rights of Property) Ordinance puts this matter beyond doubt. There are, however, several circumstances in which a body or an individual is, or may be, under a disability.

Corporations

Corporations may take and make leases provided that it is permitted by their constitutions. In the case of a statutory corporation, such as a hospital and a university, the constitution is the ordinance creating it. The ordinance will usually give express power for the corporation to hold and grant interests in land. In the case of a company incorporated with limited liability under the Companies Ordinance, section 17 confers statutory power to hold land in addition to powers found in its memorandum of association. The memorandum is usually widely drafted so as to permit the company to make and take leases.

A corporation must always act within the powers bestowed by its constitution (intra vires). If the company is a foreign company, it must not only act *intra vires* in making or taking a lease, it must also file with the Registrar of Companies a certified copy of its constitution, a list of its directors and the name of someone living in Hong Kong who can represent the company.

Partnerships

Partnerships (or firms) are unincorporated business associations and partners are liable for the acts of themselves and the other partners. A lease may be given, or taken, in the name of the partnership, or of one or more of the partners. However, all of the partners are liable to be sued if a dispute arises.[2]

Clubs

Many of the larger clubs in Hong Kong are corporations (companies limited by guarantee) so their ability to make or take leases is governed by the Companies

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Ordinance and their memorandum of association. However, most clubs, especially smaller social, sporting or recreational ones, are unincorporated associations. These kinds of club are mostly members' clubs which means that club property is owned by the members jointly. There are also proprietary clubs where the property is owned by the proprietor, usually a limited company, and run for profit. The members there simply use club facilities in exchange for their fees and subscriptions.

Members' clubs often wish to take leases of premises. The difficulty is that the club is usually not incorporated and so, unlike a limited company, it has no (fictional yet legally recognised) personality separate from that of its individual members, who are usually numerous and constantly changing. The club therefore has to appoint nominees (perhaps officers and committee members) or trustees to take the lease. Nominees are usually used for short leases, trustees for longer leases. Each nominee or trustee is personally liable if any of the terms of the lease are broken by the club members.

Infants or minors

Lawyers use the word 'infants' to describe not just babies and young children but all people under 18 years of age. The modern name for young people below the age of majority is minors. The age of majority was lowered from 21 to 18 in 1990 by the Age of Majority (Related Provisions) Ordinance (Cap 410). Before this, a lease signed by a minor was generally voidable at the minor's option. This remains the case, but if the minor decides to repudiate a contract, section 4 of the ordinance empowers the court, if it thinks it just and equitable to do so, to return any property acquired by the minor under that contract to the other party. Suppose therefore a minor takes a lease for two years from 1 January 2010. He is then 17 years old. He may declare that he will not honour the agreement and will not pay rent at any time before he turns 18 and within a reasonable time after that. If he does so declare he must, of course, also leave the premises. Let us say that the minor turns 18 halfway through the term of the lease, on 1 January 2011, and that a reasonable time to exercise his option to avoid the lease is six months. He must therefore avoid before the beginning of July 2011 or face paying the rent for the final six months. Should the minor decide to leave, he is not entitled to the return of rent which he has paid during his period of occupation; further, he is liable for the breach of any obligations which occurs before avoidance. However, he does escape liability for rent during the rest of the lease's term.

Where a landlord discovers that his tenant is under 18, he cannot use the tenant's minority as an excuse for forcing him out. If the minor wishes to remain in occupation, he may do so for the length of the lease, provided of course that he does not break the terms of the agreement. The lease is avoidable at his, not the landlord's, option.

There are exceptions to the rule that contracts, including leases, entered into by minors are voidable. When the subject matter of the contract is 'necessary' or when the contract is generally for the minor's benefit, such contracts bind the minor. 'Necessaries' are not quite the same as 'necessities' and vary with the circumstances of the case, especially the status and condition in life of the minor Most of the cases interpreting necessaries concern contracts for the sale of goods in which the minor was the purchaser. Most of the cases on contracts for the benefit of minors concern employment or apprenticeship agreements. There is

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little guidance on whether a lease is a necessary to an infant tenant. Arguably, in the case of a residential tenancy, the lease is a necessary, provided the premises are not too lavish. It may not be so if the lease is of business premises from which the minor has been running a business. Therefore it is possible that in the situation postulated above of the 17-year-old tenant, he would not be allowed to avoid the lease if the landlord raised the argument that the tenancy was a necessary.[3]

It is unlikely that a minor would purport to let premises as a landlord. There is no equivalent in Hong Kong of the English Law of Property Act provision which prohibits the holding of land by infants and declares that land must be held by trustees for the infant. In practice, however, where land is to be conveyed for the benefit of someone under 18 years old, a solicitor will ensure that the land is held by trustees (often relatives) with the minor as a beneficiary. Any lease of such land will then be granted by the trustees.

Mentally disordered persons

Mentally disordered persons may grant and accept leases only through committees appointed to look after their affairs under the Mental Health Ordinance. After a person has been certified as incapable of managing his own affairs following examination and inquiry, the committee (which often comprises relatives and a professional adviser) takes over and enters into any contracts, including leases, on the patient's behalf. Any lease entered into by the committee must not exceed three years in duration.

If the patient had entered into agreements before the committee assumed responsibility, the agreements are void if it can be shown that at the time of the agreements he was incapable of understanding the nature of the transactions.[4]

Charities

Charities have unrestricted powers to make and take leases.

Agents

Agents may enter into leases on behalf of the landlords or tenants who have employed them, provided their actual or apparent authority from their 'principals' (as the employing landlords or tenants are called) extends to signing and negotiating leases. If a landlord, for instance, places responsibility upon an estate agent to find suitable tenants, the scope of the agent's authority depends, in the first instance, on the agreement between the landlord and the agent. The landlord may limit the agent's authority to only finding possible tenants and instruct him not to enter into any tenancy agreement without the landlord's approval. If the agent goes beyond his authority and purports to sign an agreement on the landlord's behalf, the landlord may nevertheless be bound, despite the limitation in his instructions to the agent, if it is usual for that sort of agent (eg a managing agent) to have such authority or if it seemed to the tenant that the agent had full authority. In these circumstances, the law may take the side of the tenant because the agent had 'usual' or 'apparent' authority. The doctrine of apparent authority may be harsh on the landlord; however he took the risk of employing the agent.

The landlord's redress in these situations is to seek compensation from the agent for breach of their contract of agency.[5]

A landlord who is going abroad for an extended period will usually leave the letting and management of his properties to an estate agent or solicitor. He will be wise to grant the agent wider powers by giving him a power of attorney, a special kind of agency which can be created only by deed.

A landlord or tenant employing an agent should therefore be precise in his instructions as to whether the agent is merely to introduce another potential party, or is allowed to negotiate terms as well, or is allowed to go even further and make an agreement on his behalf. Even if he gives the agent permission to make an agreement to take or make a lease (or it appears to the other party that the agent has that permission, so that the doctrine of apparent authority applies), he may not be legally bound by such an agreement if it is purely oral and there is no written evidence of its existence. This is because of the special rules concerning agreements for leases, which we will shortly examine.

Parts of the rural New Territories are owned by t'so or t'ong. These are customary lineage associations or trusts, their land being held for the benefit of their members who are usually from the same clan or family. They are recognised and governed by section 15 of the New Territories Ordinance. The land is often rented out for farming or, more recently and lucratively, for vehicle parking or open storage of containers, building materials, scrap and so forth. Such associations operate through managers chosen by the members and approved by the District Office of the Home Affairs Department. These managers are agents and quasi-trustees. Once approved and registered, the managers have full power to deal with the land as though they were owners of the land. Any dealing (including a lease) should however, be approved by and executed in front of the District Officer. The Court of Appeal has suggested that this is a mere administrative requirement and need not be observed for a tenancy agreement.[6]

Squatters

Squatters, that is to say trespassers, who have acquired title to land by 12 years' adverse possession may grant a lease to that land. This is because, although they originally lacked title, they have acquired title against the registered (or paper) owner by long possession and operation of law, and by virtue of that they are able to put a tenant into possession.[7]

Agreements for leases

Another preliminary question is whether an intending landlord and tenant have entered into an agreement for a lease prior to the execution of the lease (or formal tenancy agreement) itself. Such an agreement is a contract under which the intending landlord agrees to give, and the intending tenant agrees to take, a lease in the future. It is sometimes called an 'estate contract'.

The agreement must of course satisfy the requirements of a contract: there must be offer and acceptance, consideration, intention to create legal relations and so forth. It must also be an agreement for a lease and not an arrangement of some other sort. This will be a matter of interpretation of the document or, if there is no document, what was said. The document may, for instance, constitute no more than an offer from the would-be tenant to take a lease, so there would be no

agreement until the offer is accepted by the would-be landlord. That offer may or may not be capable of withdrawal, so if it is capable of withdrawal and is withdrawn prior to acceptance, there is no agreement to lease. The document may instead be a 'booking form' (a reservation of a right to take a lease). This is particularly likely where the property to be leased is still under construction. In this case, the would-be tenant has an option to take a lease which, legally, is an open offer by the landlord to grant a lease if the tenant accepts it by exercising his option.

Large landlords often have a form or letter of offer which is quite lengthy, contains more than the basic terms, and is usually intended to be binding once signed by both parties. Such a document will invariably provide for a formal agreement or lease to be made on the landlord's standard terms or on terms dictated by the landlord.

Where the lease is particularly in demand or the landlord is the government or a public authority, the offer to lease from potential tenants may be in the form of a tender or a bid at auction. In these circumstances, the terms on which the landlord is prepared to contract will be publicised in advance to parties interested in tendering or bidding. Unless otherwise stipulated, the agreement will be made upon the landlord's acceptance of the tender or bid. In short-term tenancies of government land, the tender notice will often state that the tender together with the written acceptance of it shall constitute an agreement binding until the tenancy agreement is signed.

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Certainty

Like all contracts, an agreement for a lease must be sufficiently certain. In particular, the parties (the intended lessor and lessee) must be identified, the premises must be named or described, the commencement and duration of the term of the lease must be stipulated or identified, and the rent and other consideration must be stated so as to be ascertainable. For instance, an agreement to let named premises at a 'reasonable rent' is not sufficiently certain.[8]

Since a lease must have a certain beginning and a certain ending, if the start of the lease is not defined, there is no agreement for a lease. However, it is sufficiently certain if the commencement date can be defined by reference to an event. This may be a future contingent event provided that it has occurred by the time the agreement is enforced. So, the landlord of a shopping mall or office building under construction may wish to let the shops or offices before the building is complete to ensure that rent is received as early as possible once they are ready for occupation. The landlord will make agreements with tenants that the leases will begin when the landlord gives notice to the tenant, say within a few days of issue of the occupation permit.

The difficulties of discerning whether there is a concluded agreement for a lease and one that is intended to be binding are illustrated by *World Food Fair Ltd v Hong Kong Island Development Ltd* (2007). In this case, the parties began negotiations in 1996 for the plaintiff to lease units at the defendant's shopping mall (which was then under construction) for use as a food court and restaurant. An oral agreement concerning the amount of rent and certain other terms was reached in January 1997 when the plaintiff paid an initial deposit of HK$200,000. The date of commencement of the proposed tenancy was then uncertain because permission to occupy the building had yet to be given by the Building Authority.

In July 1997 a draft tenancy agreement came into existence (but was not signed), the plaintiff was given possession of the units for purposes of fitting them out and the defendant agreed to provide certain kitchen facilities for the food court. The plaintiff had also engaged an interior decorator to design and construct the restaurant.

The plaintiff began to look for subtenants for the food counters and to hire restaurant staff. However, after a change in management later that month, the defendant changed its mind: it no longer wanted a food court at the mall. The defendant refused to proceed with the agreement, demanded that the plaintiff leave the premises and claimed to forfeit the deposit. The plaintiff, which had incurred large expenditure in anticipation of the lease, sued the defendant for return of the deposit and damages for breach of the oral agreement.

The trial judge found that there was no agreement: the parties had only reached a broad consensus but had not gone beyond the stage of negotiations, because too many important matters remained to be agreed and everything was subject to a formal lease being agreed later anyway.

The Court of Appeal unanimously disagreed. They found that there was an oral agreement on all the vital terms for a tenancy which had been partly performed. This performance was, the judges thought, the best indicator that the parties intended their agreement to be binding. The payment of the deposit was said to be of great significance since it committed the plaintiff to taking a tenancy, and the fact that the plaintiff's workmen were allowed in to do fitting-out work was conclusive.

The Court of Final Appeal, however, took a different view. They found that there was no agreement because one of the basic terms, the commencement date of the tenancy, had not been agreed on. The payment of a deposit and the giving of access for fitting-out were consistent with, but not proof of, a concluded agreement since these acts might have been done in anticipation of a binding agreement to be made later. Indeed the description of the deposit as 'initial' suggested that it had been paid to show the intending tenant's seriousness about taking a tenancy and that the parties had not yet reached final agreement.[9]

World Food Fair is an unusual case in that the parties made no agreement in writing despite the scale and value of the contract they were contemplating. The practice of large landlords, not to mention the parties' legal advisers, would not allow the arrangement to proceed so far without at least a letter, or an exchange of letters, signed by both parties setting out their understanding. These documents still need to be construed to see if they evidence a concluded agreement for a tenancy and one that is intended to be binding.

Oral arrangements raise an additional problem of evidence which is dealt with a little later in this chapter. Assuming that there is a preliminary signed document, what approach should be taken towards ascertaining whether it is a contract for a tenancy?

If negotiations between the parties are continuing, this probably means that there is no contract as yet because there has been no offer which has been accepted. Where the document provides for the making of a formal agreement later, this may indicate that any agreement made in the document is not meant to be binding because it is conditional upon the making of the formal agreement. However, equally it may be the intention that the later agreement will simply formalise the binding temporary agreement made in the document. Time-honoured words such as 'subject to contract', 'subject to lease' or similar should be used on correspondence and other documents to ensure that the agreement is

conditional upon a further, formal agreement being entered into. Therefore, at the date of the documents, there is no contract even though one or both parties may believe they have a 'gentleman's agreement', one binding in honour only. Provisional agreements (which when they are in Chinese are sometimes called 'lum see' agreements) cause particular problems in this regard. Such agreements, if sufficiently certain, have binding legal effect between landlord and tenant even though they may be intended to be 'holding agreements', temporary in nature. If, however, they are incomplete, tentative or conditional, probably they are not binding.[10]

When deciding whether an agreement has the force of a contract, a court has to read the whole document and interpret its contents objectively, in the context of facts surrounding its making. The description of an agreement as 'provisional', 'interim' or 'temporary' is not inconsistent with it being binding and does not mean that it is an intention that a formal agreement shall be entered into later. These descriptions may indicate that the agreement shall be operative for the time being. The fact that the agreement provides for payment of a deposit is a neutral factor, since the deposit may simply signify the good faith of the proposed tenant or serve as a 'booking fee' so as to reserve the premises pending the making of a binding agreement. Further, a provision for forfeiture of the deposit, although it may be enforceable on its own, does not necessarily make the rest of the agreement enforceable.[11] Consequently, the performance of acts preparatory to a lease after the signing of a document, such as the tenant being given access to the premises and commencing fitting-out work, is similarly equivocal since these acts could be pursuant to a binding agreement or could be merely in confident anticipation of a binding agreement.

Ironically, the estate agent's caution not to over-commit his client, which leads the agent to stipulate that a preliminary agreement is subject to contract, often defeats his or her desire to earn a commission payment. Almost always, an agent's commission becomes due only on the signing of the tenancy agreement, so if either party declines to enter into the formal contract, the agent loses his right to be paid. In rare cases, the preliminary agreement will stipulate that the agent's commission is to be paid regardless of whether the tenancy is entered into, so the preliminary agreement may have effect as an agreement between the potential tenant and the agent, even though it has no effect as between landlord and tenant.[12]

The uncertainty may not necessarily arise from the terms which were agreed or from the parties' intention, rather, it may arise from whether the agreement was a new tenancy agreement or merely a continuation or variation of the existing one. This is prone to happen where the alleged agreement is between a sitting tenant and the landlord, rather than between a new tenant and the landlord. For instance, in one case concerning a tenancy of a car park where the rent could be increased under the existing agreement, the tenant interpreted a letter in which the landlord increased the rent and deposit (both of which the tenant was willing to pay) as an offer of a new tenancy rather than a variation of the existing tenancy. The Court of Appeal however held that it was a variation, not a new tenancy agreement.[13] In other cases involving sitting tenants, where the alleged new tenancy agreement is entirely oral, the question may be whether any such agreement existed at all. This is especially likely to happen if the tenant is desperate to stay on but the landlord, whilst initially willing to negotiate, decides not to grant a new tenancy.

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Chapter 6

Rent

Nature of rent

Rent, or 'rental', is part of the return or recompense (called the 'consideration' by lawyers) to the landlord for the grant of the leasehold interest to the tenant. It is not the whole of the consideration received by the landlord for his grant, since he also receives the benefit of other obligations expressly or impliedly agreed to by the tenant in the lease. It is, however, the part of the consideration which the landlord is most concerned to receive and the amount of rent is a fundamental aspect of the tenancy agreement.

For the tenant, rent is what he pays for the possession of the land, and the freedom to use and occupy it. That is not to say that all sums paid for the use and occupation of land are, legally, rent. For instance, an agreed payment by an occupier under a licence agreement is not rent—though the parties may call it such. 'Rent' is an appropriate term only where the agreement under which it arises is a lease. Management or service charges, unless expressed as part of the rent, are not rent. Nor are payments reserved on the hire or hire-purchase of goods (such as a ship, car or office equipment), although the description 'lease' is often loosely used for such arrangements.

Rent usually consists of money but it may consist wholly or partially of goods and services if that is agreed by the parties. So, for instance, the tenant may pay part of his rent in cleaning and looking after the common areas of the building in which he lives or in working for the landlord. When the tenancy is closely tied to the tenant's employment by the landlord, so that if the tenant loses his job he also loses his lease, it is known as a 'service tenancy'.

It is said that 'the possibility of distraining is the mark of rent', that is, if the landlord can distrain for the sum due, the sum must be rent. However, this reasoning is unhelpful, because it is circular. 'Distraint', or 'distress', is the seizing and detention of the tenant's goods followed by their eventual sale in order to recoup rent which is owed to the landlord. The details of distress are examined later, but a rule of distress is that the landlord may distrain only for unpaid rent. Hence if the landlord can distrain for the debt, the debt must be for rent due. And when is the debt for rent? When the landlord can distrain for it.

Terminology of rent

The word 'rent' is often qualified or described by adjectives. Usually the meaning is easy to gather, but occasionally the terminology is technical or confusing. The more common types of rent encountered are given below.

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Best rent

This is the highest market (or rack) rent reasonably obtainable for the particular premises on the terms of the particular lease. The exception in section 6(2) of the Conveyancing and Property Ordinance permitting a lease for three years or less to be made orally requires that the lease be at the best rent.

Controlled rent

This is the rent permitted under the legislation controlling the amount of rent which landlords may charge. In Hong Kong there were such provisions in the Landlord and Tenant (Consolidation) Ordinance but since 1998 that ordinance no longer controls rent, so the terminology is historical. That legislation generally controlled increases in rents, so that the controlled rent usually consisted of the original rent agreed between the parties plus any increases permitted by the ordinance.

Current rent

This is simply the rent now being paid by the tenant. Until the abolition of rent controls, the current rent could have been that agreed between him and his landlord or it may be the prevailing market rent which, under the legislation, was set by the Lands Tribunal.

Ground rent

This is a relatively small sum reserved by the landlord when he grants a long lease for the purposes of the tenant erecting a building on the land. The landlord will be more concerned about the purchase price (the 'premium') than the ground rent. In Hong Kong, the landlord usually in this position is the government, which sells the land for a premium and reserves a ground rent, previously called the Crown rent, now called the government rent. This rent was traditionally small but in all government leases which began after 1997 (including all in the New Territories) it is three per cent of rateable value, a substantial sum—in effect a tax on the annual value of the land.

Head rent

This is the rent paid by the tenant to the head landlord where the tenant has sublet to a subtenant. The lease between the landlord and tenant is the 'head lease' and the current rent payable under it is the 'head rent'.

Peppercorn rent

This is a nominal, almost valueless amount. It is really a symbolic sum agreed as rent between the landlord and tenant, usually to make it clear that a lease, as opposed to a bare licence, is intended between them. The landlord might grant a lease at a peppercorn rent to a good friend, close relative or favoured organisation such as a charity.

Rack rent

The full annual value of the premises on the market at the commencement of the lease is the rack rent. It is the prevailing market rent (sometimes called the 'fair market rent'), or close to it.

Turnover rent

This is a rent which is calculated according to the business turnover of the tenant. It is sometimes used in leases of shops, restaurants, and other retail premises especially at high-class shopping centres. The amount is a percentage of the tenant's gross receipts and so it fluctuates in accordance with the tenant's business fortunes. It is usually charged in addition to a base rent.

Amount of rent

The amount of rent must be agreed between the parties. In a written lease it will be stipulated in a clause, technically called the 'reddendum'. Examples are in clause 1 of the first two tenancy agreements in appendix 1. The amount must be certain, or capable of being calculated with certainty, otherwise the agreement will be void for uncertainty. Where, as is usual, the rent is agreed as a certain amount of dollars there is no difficulty. Similarly where the rent is expressed at a unit rate, there is usually no difficulty since ascertainment of the amount is a matter of arithmetic. In one case, the tenant offered to lease a shop, then under construction, expressed to be of a lettable area of approximately 1,770 square feet at a rental of so much per square foot. The shop transpired to be 1,800 square feet in size, and an objection that the rent agreed was not sufficiently certain was rejected.[1]

A rental clause which allows for increases in rent (a 'progressive rent') is acceptable, provided it is clearly drafted. For instance, a clause setting an amount of money rent with provision for annual percentage increases would be sufficiently certain. So would a clause which allowed for periodic changes in rent by reference to some published index, such as the Consumer Price Index, since the amount of alteration would be capable of calculation. The landlord may therefore commit to a lease of (by Hong Kong standards) long duration and by such a 'rent escalation clause' protect himself against a decline in the value of the rent.

Another device for the benefit of the landlord is a clause providing for a 'turnover rent'. This is found only in more sophisticated commercial leases. It links the amount of rent to the gross income, or turnover, of the tenant's business conducted at the premises. Above a certain minimum or base amount, the rent is a proportion of the gross income. The proportion often varies according to the amount of income. So the rent paid depends upon the success of the tenant's business.

The more complex the protection the landlord seeks, the more precise the words used in the clause must be and the more sensible it is to have the clause professionally drafted. In one case, *Shum Wai Kwan v Ho Sun Lee Mahjong School* (1982), a home-made clause, apparently designed to protect the landlord against inflation and devaluation of the dollar, which had been written on a standard Chinese tenancy agreement, could not be given sense by the courts and was consequently declared void. The clause attempted to link the rent in some

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way to the rise in the value of gold. There is no reason in principle why the rent should not be related to the value of gold, or any other commodity, but the mechanics of the link, the relevant quantity of gold to be used, and the relevant dates for valuation must be precise.

The courts strive to save unclear rental clauses. The test they apply is: is the concept underlying the clause uncertain when one approaches the words with reasonable goodwill? This was laid down in an English case, *Brown v Gould* (1972), where the rent was to be fixed 'having regard to the market value'. Even though no machinery was laid down for determining the market value, it was felt that market value was a sufficiently certain concept for the clause to be given meaning.

Similarly, a provision in a lease for rent to be fixed by arbitration, or entitling the landlord to vary unilaterally the rent on giving notice, is not void for uncertainty. The underlying concepts are both certain. However, a clause providing for the rent 'to be agreed' has been held void.[2]

Rent review clauses in longer leases, particularly leases of business premises, may provide for the rent to be increased by agreement or, failing that, by arbitration or expert assessment. Again, it is best for the clause to be precise about the machinery for arbitration (it is common for each side to appoint a surveyor, with an independent surveyor as umpire). In England, a considerable body of law and professional expertise has built up as a result of rent reviews. Hong Kong has not been so blessed, largely because of its custom of shorter fixed-term tenancies. However, rent review clauses are by no means uncommon in business leases of larger premises and in such instances, the principles enunciated in the English cases are invariably followed. Those principles are discussed later in this chapter.

In solicitor-drafted leases, the reddendum will often state that the rent due is 'clear' or 'to be paid without any deduction'. This is to prevent the tenant from making any deductions from the rent, for instance, where he has paid the rates on the premises or has paid for repairs which he says are the landlord's responsibility. A proviso against deductions cannot, however, prevent the tenant from making deductions allowed by statute.

A deduction is different from a set-off. Deductions are, strictly, payments concerning the premises made by the tenant on behalf of the landlord, whereas a set-off is a claim by the tenant against the landlord. It used to be thought that set-off against rent was not possible because the tenant's covenant to pay rent was independent of other covenants, such as those of the landlord, but that is no longer so. In order to set such a claim off against rent, the claim must have a sufficiently close connection with the landlord's claim for rent (eg it arises out of the landlord's obligations under the lease) although it need not be for an ascertained amount.[3]

The tenant's right of set-off may be excluded by the reddendum but clear words must be used. It is generally not sufficient to say that the rent must be paid without any deduction for that will rule out deductions only. The exclusion will be construed strictly, against the landlord. If the exclusion is for 'offset', this may not be enough to bar a set-off. If what is excluded is set-off, this will cover set-off at law but will not extend to equitable set-off. But if the clause forbids any claim to legal or equitable set-off, probably no feat of judicial ingenuity can allow the tenant not to pay the full rent.[4]

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Rent control

One of the principal purposes of statutory intervention in the landlord-tenant relationship has been to limit the amount of rent which the tenant is required to pay. In the past, periods of housing shortages have led to the imposition of such controls in Hong Kong. Controls, first on the absolute amount of rent that could be charged and later on the amount of any increase in rent, existed for many decades (a summary of their history will be found in chapter 13 of the 4th edition of this book). In the latter case, the controls applied to domestic lettings only.

The last rent controls were removed in 1998. This was achieved by virtue of not renewing the two parts of the Landlord and Tenant (Consolidation) Ordinance which contained the controls. The two parts remain on the statute book, however, occupying the first 70 or so sections of that ordinance. So the sections containing rent restrictions are technically still law even though they are not in operation—forlornly surviving in a sort of limbo, awaiting re-engagement in the unlikely event that a lack of housing or a change in political circumstances should again demand that the law intervene in the rental market.

By the time of their non-renewal, those controls had been gradually superseded by a different sort of intervention introduced in 1981, whereby tenants of residential premises were entitled conditionally to a new lease at prevailing market rent. Since this rental was set by reference to the market, it was strictly not a restriction on the level of rent but the law did mean that the parties were not entirely free to negotiate their own rent. However, this law, which was in Part IV of the ordinance, was removed in July 2004.

Rent-free periods

In commercial lettings and occasionally even in residential lettings, a landlord may agree that rent shall not be payable for part of the term. Such rent-free periods tend to serve one or both of two purposes. The first and original purpose is to provide a period, typically one or two months, at the start of the term to facilitate the tenant's fitting-out of the premises. The justification for this type of 'rent-free' (as it is known to estate agents and valuers) is that the tenant cannot use the premises until they are fully decorated, and so gains no value from them.

The second purpose of giving the tenant relief from paying rent is to act as an incentive to the tenant to enter into the tenancy. Rent-free periods of this sort are a rent-reduction in disguise: rather than reduce the rent level throughout the rest of the term, the landlord concentrates the discount to just a few months. In that way he may claim that the rent achieved is higher than in fact it is. This sort of 'rent-free' tends to be an extension of the period reasonably necessary for fitting-out and may also include months in the middle and towards the end of the lease term. This arrangement therefore constitutes an incentive to the tenant to remain in the premises until the end of the term and acts as protection to the landlord against the tenant taking the benefit of the entire rent-free period if the period were to be entirely in the early months of the tenancy before abandoning the lease.

A rent-free period means only that the tenant does not have to pay rent during that period. Since it is part of the term, the tenant still has to pay management fees and other outgoings during the period, unless of course the landlord specifically agrees that these too shall not be charged.

Apportionment

Rent may be apportioned, that is, divided up, either as a result of a break in time or as a result of a division of the estate in the land. Rent is apportionable as a result of a break in a period of time under the Apportionment Ordinance. Section 3 of that ordinance provides that, unless rent is payable in advance (as will often be the case), rent accrues from day to day and is apportionable accordingly.

Suppose that L lets land to T at an annual rent of $36,500 a year, payable on 31 December each year. The lease is ended, perhaps by surrender, on 31 January in a particular year. T owes rent to L for the period 1 to 31 January. Rent accrues at $100 a day. So T must pay $100 x 31, which is $3,100, though not until 31 December, since the Apportionment Ordinance does not affect the date for payment.

A similar apportionment applies if the landlord changes during the period of the lease. Suppose that in the above example, instead of the lease ending on 31 January, L had sold the flat to B (the buyer) on that day. Although T will pay the rent at the end of the year to B as the new owner, that rent will be apportioned between L and B, L receiving $3,100 ($100 for each day on which he was the landlord) and B keeping the balance.

Apportionment as a result of a division of the estate in the land arises either from a division of the reversion by the landlord or of the premises by the tenant. This type of apportionment is not controlled by the Apportionment Ordinance. If the landlord assigns part of his reversion to a third party, or assigns the whole of his reversion to several people, the rent received may be apportioned between the new holders of the reversion. The tenants pay the rent to the original landlord, who then pays appropriate portions to the new holders, unless the tenant has consented to the apportionment or it has been ordered by the court. It might, for instance, be ordered by the court as part of the financial arrangements between the landlord and his former wife following their divorce. If the tenant consents to, or the court orders, the apportionment, the tenant should pay the appropriate parts of the rent to the new holders.

The demised premises would be divided if, for instance, the tenant surrendered part to the landlord, the landlord validly re-entered part, or part of the land were to be washed away. Here the tenant may, unless the contrary is agreed in the lease, apportion his rent so that he will, in the future, pay in respect of the part which he retains. Apportionment is also possible, though not binding on the landlord (unless by court order or agreement), where the division of the premises is caused by the tenant assigning part to a new tenant. The landlord may insist that the original tenant continue to pay the whole rent, collecting a portion from his assignee, or he may agree to the old and the new tenant paying their respective portions of rent to him.

Apportionment of the government rent is possible under the Government Rent and Premium (Apportionment) Ordinance. Land is sold in lots and government leases do not contain a provision for apportionment of the rent (or premium) if the lot is divided by the buyer transferring part to another. The buyer, the government lessee, remains liable for the whole of the rent. So long as he retains possession of part of the land (the 'remaining portion'), he must collect a proportion of the rent from the other owners of the parts.

The difficulty is that if he or a successor defaults in paying the government rent, the administration can exercise its rights of re-entry over the whole lot. The re-entry would affect the owners of the other parts (even if they have been paying

their parts of the rent regularly) and any tenancies or mortgages they and the government lessee may have. This is obviously inconvenient, not to say unfair, especially where there are many flats built on the site.

The ordinance, however, comes to the rescue. It enables the Director of Lands to apportion the government rent (and premium) between the owners of flats which stand on the land. He may apportion if he thinks it desirable, or at the request of the owners. Also, the owners can agree an apportionment between themselves and ask the Director to approve it.

Where the Director of Lands makes the apportionment, it will usually be on the basis of the shares of each owner in the building, that is, one share for each flat owned. In certain circumstances, the apportionment can be on the basis of a valuation of each flat by the Rating and Valuation Department. Once the apportionment has been made, each flat will be regarded as being held on a separate lease containing the same provisions as the government lease of the lot, except of course for a covenant to pay the apportioned government rent (and premium) instead of the original rent (and premium).

Rent revision and review

In longer leases, which in Hong Kong largely means lettings of high-class business premises, provision may be made for the periodic revision of the rent during the term. This may take the form of an agreed amount of rent to take effect every year or two. It could also take the form of variation of the amount of rent according to the changes in an index such as the consumer price index, or some other measure such as the value of gold. However, such provisions are rare; it is more common for commercial landlords to allow for revision in accordance with the tenant's business turnover or under a clause which adjusts the rent to market level after a few years.

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Turnover rents

A turnover rent is apt in the letting of retail premises such as a shop or restaurant in a modern commercial mall because it links the amount paid by the tenant to the fortunes of his business. The rental will tend to be proportional to the business' earnings and so the landlord will have an incentive to promote the mall and to ensure that it is well-managed and attractive to customers.

A typical arrangement might be that a basic rent is agreed at a set rate per square foot on an agreed area (usually the lettable space), to last either for the whole of the term, or for each year or period of the term (in which case the rate may escalate every period). An additional or alternative rent is agreed calculated according to a percentage of the tenant's gross monthly sales. This turnover rent will usually only be a few per cent of the gross sales and may be capped at a certain amount of the basic rent so that the tenant knows the maximum rental exposure. If the turnover rent works out at less than the basic rent then only the basic amount is payable. The base rent gives the landlord a minimum income while the turnover rent will ensure that the landlord shares in any success that the tenant's business has. The total rental received will fluctuate according to the amount of business done.[5]

From the landlord's point of view, the drawbacks of a turnover rent are that the total rental to be received is unpredictable and depends upon the co-operation

Further reading

Hill and Redman's Law of Landlord and Tenant (Looseleaf), Vol 1 (Lexis Nexis) ch 10.
17 (1) *Halsbury's Laws of Hong Kong* (2007 reissue), **[235.289]-[235.320]**.

Chapter 10

Assignment and subletting

Since a tenant's leasehold is an interest in land, he may deal with it as he likes during and for the period of the lease. He may transfer the leasehold of all or part of the premises to another for the whole of its remaining duration: this is 'assignment'. He may create a shorter leasehold interest out of the lease, transferring possession of the premises (or part of the premises) to another for that shorter period: this is 'subletting', sometimes called 'underletting'. He may retain the lease and possession of premises, but allow another into occupation, in which case he has not assigned or sublet but granted the occupier a 'licence' (the distinction between a licence and a lease was dealt with in chapter 1).

These powers of transfer are, however, subject to any stipulations in the lease. In practice, written tenancy agreements always contain covenants restricting the tenant's powers of transfer, although the extent of the restrictions vary from agreement to agreement. The nature and scope of typical restrictions are examined later in this chapter.

It is important to ascertain whether a tenant's dealing with his interest is as an assignment, subletting, licence or something else, because it tells us whether he has broken a covenant in the lease. However, even where the tenant has unfettered power to alienate his interest, the distinctions are relevant, particularly to the question of whether obligations arising under the lease have been transferred along with the interest.

Assignment

An assignment is the transfer of a leasehold interest between living persons. If a lessee, T, holds a 50-year lease from a lessor, L, T can sell or give the remaining part of that interest to a third party, X. Here, T is the assignor, X the assignee. The process, and the document which achieves it, is called an assignment.

Usually the assignor sells, rather than gives, his interest to the assignee. Further, his interest will be saleable only if there are several years of the lease's term still to run. In practice, leases of less than three years' duration are rarely assigned.

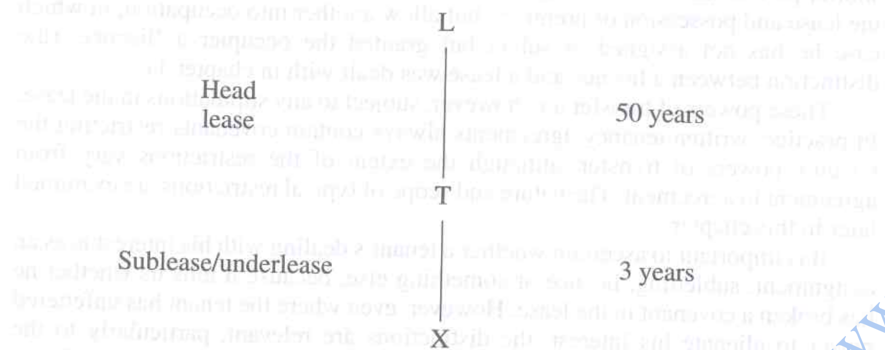
Following an assignment, the assignee replaces the assignor as tenant: X replaces T as the tenant of L. This is because T has granted X the whole of his estate in the land. However, no new tenure has been created, because L has not granted a fresh lease to X. There is no contract between L and X, though there is a landlord-tenant relationship by virtue of X's taking T's place. In the language of lawyers, there is no 'privity of contract' between L and X, but there is 'privity of estate'.

Although L and T are no longer landlord and tenant, their contract whereby each agreed to be bound by the terms of their lease still stands. So, although there is no longer privity of estate between L and T, there is still privity of contract.

Subletting

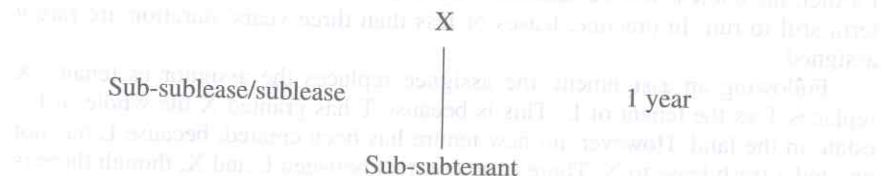
Contrast this with the situation where T subleases to X. When T sublets, he carves another shorter leasehold interest out of his leasehold interest. Instead of transferring the whole of the remaining 50 years of his lease to X, he creates another term which by definition must be shorter (if only one day shorter) than the remaining portion of his own lease. T therefore does not cease to be tenant. He retains his estate in the land and continues to have privity of both contract and estate between T and L.

At the same time, T has created a lease between himself and X. Between them, T is the landlord and X the tenant. Their lease is a 'sublease' or 'underlease'. Assuming this sublease is of three years' duration, the situation can be illustrated as follows:



To avoid confusion, L is often referred to as the 'head landlord' and the lease he has granted to T as the 'head lease' or 'principal tenancy', T is often referred to as the 'principal tenant' and X as the 'tenant'.

Subject to any covenants in his lease from T, X may himself create a lease out of his three-year sublease in favour of a 'sub-subtenant'. The duration of that sub-sublease must, however, be shorter than the outstanding portion of X's three-year sublease. In such circumstances, the lease between T and X is sometimes referred to as an 'underlease' to differentiate it from the lease between X and his own tenant, which is then called a 'sublease'.



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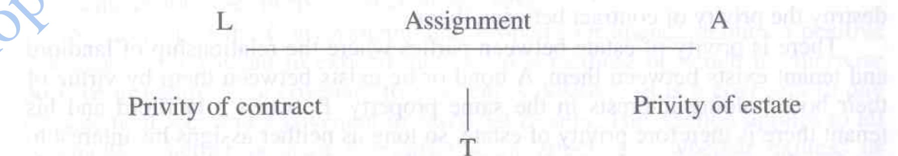
The tenant who holds from X may in turn, subject to restrictions in his lease, create a shorter lease out of his own, and so on down the line. In this way, a chain of subtenancies may be created. It is not unusual in Hong Kong, especially where oral agreements are used, to find such a chain.

Where T grants a sublease, he is transferring to X an interest which is less than the interest which T already holds from L; and the sublease must be at least one day shorter than the head lease. If T, while saying he is granting a sublease, in fact grants X an interest which is of the same length as (or purportedly greater than) T's interest, the transaction must be an assignment. So, if L grants T a term of 50 years and T occupies the premises for 10 years, then purports to grant a sublease to X of 40 years' duration, T is in fact disposing of the whole of his remaining estate—it is an assignment, not a sublease. The substance, not the form, of the agreement is what is important.[1]

Landlord's assignment

A landlord may also assign his reversionary interest in the land. That is, he may sell or give away his ownership, subject to the existing lease. Where this occurs, the assignee (A) replaces L as the landlord. There is therefore privity of estate created between A and T, although L and T remain in privity of contract.



If A later assigns the reversionary interest to B, the latter becomes the landlord and acquires privity of estate with T. There ceases to be privity of estate between A and T; of course there was never any privity of contract between them.

Formalities

Both assignments and subleases create legal estates in land. Therefore, under section 4 of the Conveyancing and Property Ordinance, they must be executed by a deed (previously only writing was required). There is an exception for leases (including subleases) of shorter than three years' duration at the best rent which can be reasonably obtained without a premium. So, since subleases tend to be of short duration, they are usually not made by deed.

An assignment or sublease made orally or by writing which does not constitute a deed may however be treated as a contract to assign or lease. Where the agreement is in writing and is signed, it will comply with section 5(1) of the ordinance and may be enforceable by an order for specific performance. Where the agreement is oral, it may still be enforceable if there is an act of part performance.

Running of covenants

The distinction between privity of contract and privity of estate, and therefore the distinction between assignment and subletting, is relevant to the question of whether, and what, obligations in the lease are transferred when one (or both) of the parties transfers his interest in, or possession of, the land. The problem of 'running of covenants', that is, which covenants bind transferees, is the usual context in which the distinction between assignment and subletting is discussed.

Privity of contract and of estate

There is privity of contract between parties where they are each parties to the same legally enforceable agreement. There is a bond or tie between them arising out of their contract. Between a landlord and his tenant there is privity of contract because they are both parties to the same lease. Between a tenant and his subtenant there is similarly privity of contract.

However, there is no privity of contract between the head landlord and the subtenant, and between a landlord and the assignee of his tenant. Similarly, there is no privity of contract between a tenant and the assignee of his landlord. The fact that one (or both) of the parties has assigned his interest, however, does not destroy the privity of contract between them.

There is privity of estate between parties where the relationship of landlord and tenant exists between them. A bond or tie exists between them by virtue of their both holding interests in the same property. Between a landlord and his tenant there is therefore privity of estate, so long as neither assigns his interest to another. If one does so, the privity of estate (but not of contract) between them is destroyed and replaced by a new privity of estate between the other party and the assignee of the first party. Similarly, between a tenant and his subtenant there is privity of estate until one (or both) assigns his interest. There is no privity of estate, however, between the head landlord and the subtenant.

Parties may therefore be in both privity of contract and privity of estate, or they may be in one but not the other; or they may be in neither kind of privity.

Rules as to enforceability of covenants

These depend principally upon the kind of privity, if any, which exists between the parties.

Where there is privity of contract (irrespective of whether there is any privity of estate) in principle all covenants are enforceable. This is simply the general law of contract: all parties to an agreement are bound by its terms. So, a lease being a kind of contract, the parties to it (landlord and tenant, principal tenant and subtenant, and so on) are bound by the promises made in it.

Where there is privity of estate but no privity of contract, only those covenants that have reference to the subject matter of the lease or, in the older but less cumbersome phrase, 'touch and concern the land' are enforceable.[2] This means that if L grants a lease to T which T subsequently assigns to A, not all the covenants in the lease will necessarily be enforceable by L against A. L can enforce against A only those which touch and concern the land—though L may enforce them all against T, with whom he is in privity of contract. Similarly, if L

subsequently assigns his interest to a new landlord, A will be able to enforce against the new landlord only those covenants which touch and concern the land. Which covenants touch and concern the land is considered later in this chapter.

Where there is neither privity of contract nor of estate (for instance, as between landlord and subtenant), in principle no covenants are enforceable. However, there are important exceptions—so important as in practice to make them greater than the rule. The exceptions arise in equity, which generally permits restrictive covenants to be enforced, and under statute, which has widened the equitable exception and which also permits covenants to be enforced between owners of units in the same building.

The equitable exception arose under the rule in *Tulk v Moxhay* (1848). Equity bounded this exception with three rules, although these have been eroded by statute.

The first rule was that in order to be enforceable in the absence of privity, the covenant had to be restrictive, that is, negative in substance. A covenant may be positive in form, but negative in substance. The covenant in *Tulk v Moxhay* is a good example, for it required the garden in the centre of a London square to be maintained in an open state, uncovered with buildings. Since the covenantor was not required to do anything positive, merely to refrain from building, it was a restrictive covenant. Similarly, a covenant to use premises for only residential purposes is positive in form, but negative in substance, since it forbids the use of the premises for other purposes such as business.

Section 41 of the Conveyancing and Property Ordinance defines a positive covenant as a covenant to expend money, do something or which is otherwise positive in nature: so a covenant to pay rent is positive, as is a covenant to pay management fees and a covenant to carry out repairs. This section applies to all covenants, whether positive or restrictive in effect, and whether express or implied, and irrespective of when they were entered into, which relate to the land of the covenantor and the burden of which is expressed or intended to run with his land. It provides in subsection (3) that subject to one qualification in subsection (5), all such covenants shall be enforceable by the covenantee, his successors in title and persons deriving title under him against the covenantor and his successor in title and persons deriving title under him and also against occupiers of the land. The qualification in subsection (5) is that a positive covenant shall not be rendered by section 41 enforceable against, amongst others, a lessee from the covenantor (eg a subtenant holding from a covenanting tenant). So, the section did not intend to alter the first rule. The distinction between positive and negative covenants remains relevant when considering enforceability of covenants between parties who are not in privity of contract or privity of estate.

The second rule was that the covenant must have been intended to run with the land demised: it must not be a purely personal covenant binding only the covenantor. It may be possible to deduce such an intention from the wording of the lease (for instance if the tenant covenants on behalf of himself, his successors in title and those deriving title under him) or from the nature of the covenant. Since 1 November 1984 this intention has been presumed, by virtue of section 40 of the Conveyancing and Property Ordinance, irrespective of when the covenant was made. Consequently, the rule is an obstacle to enforcement in only those exceptional cases in which the presumption is rebutted by express contrary intention.

The third rule was that the subtenant must have notice of the covenant. This is an instance of equity protecting a bona fide purchaser of a legal estate for value

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without notice. This too is eroded by the Conveyancing and Property Ordinance. Under section 41(9) notice is not a requirement of enforceability where the covenant is registered in the Land Registry.

The effect of the rule in *Tulk v Moxhay* and these statutory modifications to it is to construct a wide exception which permits a landlord to enforce a negative or restrictive covenant against a subtenant notwithstanding there is neither privity of contract nor privity of estate between them. The only limits on this exception are that the subtenant must have notice of the covenant, unless the covenant is registered at the Land Registry, and that the covenant must not express itself to be personal.

By virtue of section 41(3), virtually all restrictive covenants which are enforceable against the present owner of the land and which relate to the land (eg those in the deed of mutual covenant) are enforceable against any lessee or occupier of that land. So a tenant, subtenant or even a licensee may find a covenant being enforced against him even though he did not himself agree to or know about the covenant.

The owner is most likely to find a covenant being enforced against him by the government, the management of the building or owners of other flats in the same building. Although an owner of one flat is not usually in privity of contract—let alone privity of estate—with other owners, section 41(3)[3] permits the owner to enforce a restrictive covenant in the deed of mutual covenant and which relates to the land against other owners. It goes further and permits that covenant to be enforced against the tenant of the flat or other occupier.

The effect of these rules is that a covenant will often be enforceable by the landlord against the occupant, whether sublessee or assignee. A covenant will always be enforceable by the landlord against the original tenant during the life of their lease, for they remain in privity of contract. This may seem harsh on the original tenant, since he will no longer be in possession and may not therefore be in a position to see that the covenant is complied with. However, the original tenant should protect himself by insisting that any sublease or assignment granted contains covenants identical to those in his own lease and a clause by which the subtenant or assignee agrees to indemnify him if he should be sued by the landlord in respect of a breach of covenant which he did not himself cause.

A landlord who assigns his reversion should similarly extract an indemnity from his assignee. If his successor were to break one of the landlord's covenants, the tenant could sue him instead of (or as well as) the assignee.

Covenants relating to land

For a covenant to be enforceable against an assignee (whether an assignee of the term from the tenant or of the reversion from the landlord) at common law it must touch and concern the land or the fixtures (notably the buildings) on the land. This proposition is preserved and extended in more modern, yet more prosaic, language by sections 39, 40 and 41 of the Conveyancing and Property Ordinance. Section 39 provides that the benefit of covenants relating to any land shall be deemed, unless the contrary intention is expressed, to be made on behalf of, respectively, the covenantee and the covenantor and their successors in title. Section 40 provides similarly for the passing of the burden of such covenants; and section 41, as we have seen, provides for restrictive covenants to be enforceable if they relate to the land of the covenantor.

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The idea is that if a covenant relates to the land, it becomes imprinted upon and part of the estate. Therefore it is a property interest as well as a covenant and because of this, it 'runs with the land' and passes from assignor to assignee of the land. Interests and obligations are thereby passed with the land to the assignee and are vested in and imposed upon the assignee even though he was not a party to the lease which created them. Conversely, the covenant must not be purely personal to the covenantor and the convenantee. If it is only a personal covenant, neither its benefit nor its burden can be transferred. It is personal unless it affects the landlord as landlord and the tenant as tenant.

The test for whether a covenant touches and concerns the land is principally whether the covenant affects the nature, quality, mode of use or value of the land of the covenantee. Even if it does so, the covenant will still not touch and concern the land if it is expressed to be personal or if it benefits only the current landlord of the covenantee's land and, if separated from that land, would cease to benefit that covenantee.[4] This may sound rather complicated. However, in practice nearly all the covenants commonly found in written leases relate to the land, as do all the covenants implied into the tenancy by law. The tenant's covenants to pay rent, to pay rates and taxes, to repair, to insure against fire, to use the premises for domestic (or business) purposes only and against assignment and subletting all relate to the land. So do the landlord's covenants for quiet enjoyment and to renew the lease.[5]

Difficulties arise when we move away from the standard covenants. For instance, a tenant's covenant not to permit a named person to be concerned in the conduct of the business carried on at the premises has been held to relate to the land, but a covenant not to employ certain persons has been held to be a purely personal obligation.[6] A tenant's covenant to buy beer for a public house, or petrol for a filling station, only from the lessor has been held to relate to the land, but a landlord's covenant not to build or keep a public house within half a mile of the premises has been held not to.[7] These examples show that the difference is not great between a covenant which runs with the land and one which does not do so. Due to the range of possibilities, there is inevitably a grey area in which it will not be clear whether a covenant is personal or relates to the land.

Generally, a covenant does not relate to the land if it refers to property other than the premises or to a person other than the landlord and the tenant. So, a covenant to pay rates in respect of other land or to repair other property would not run with the land, neither would a covenant to pay an annual sum to a third person. Even so, it has been held that a landlord's covenant not to build on a certain part of the adjoining land relates to the leased land.[8] A covenant does not, however, relate to the land just because it refers to both of the parties to the lease—its content may nevertheless show that it is solely personal. So, it has been held that covenants by the landlord to sell the land for a certain price to the tenant if the tenant so chooses, to compensate the tenant at the end of the lease unless a new lease is granted and to pay at the end of the lease for chattels which are not fixtures, do not run with the land.

A covenant by a surety to guarantee performance of covenants in the lease does touch and concern the land. Since this is a covenant about covenants in the lease and concerns a guarantee of performance of the lease terms including those which relate to the land, it might be thought that a covenant by the landlord to repay a deposit paid by the tenant to secure performance of the lease would also touch and concern the land. So the Court of Appeal held in *Hua Chiao*

Chapter 15

Private residential lettings

All references to 'the ordinance' and to sections in this chapter are to the Landlord and Tenant (Consolidation) Ordinance unless otherwise indicated.

Background

Throughout the second half of the twentieth century and for the first few years of the twenty-first, legislation interfered with two of the most fundamental terms of the relationship between landlord and tenant: the length of the letting and the amount of rent to be paid during that letting. This interference was principally with respect to lettings of dwellings in the private sector, although for a time business tenancies were also affected. A summary history of the statutory intervention will be found in earlier editions of this book.[1] The degree of interference tended to vary according to the age and value of the property and the age and length of the tenancy.

Ordinances providing for rent control or security of tenure, or both, were passed at various times in reaction to pressures upon housing, with the result that they were scattered about the statute book. Early in the 1970s they were combined with other ordinances concerning landlord and tenant, and were brought together in one piece of legislation. This legislation was the Landlord and Tenant (Consolidation) Ordinance. The consolidation then became the vehicle for further legislative interference, achieved through amendment of various parts of the consolidated ordinance.

In 1981, extensive amendments were made to the ordinance with the aim of gradually releasing the controls upon the freedom of landlord and tenant to make whatever bargain they wished. The most significant of these changes was the introduction of 'the new Part IV'. The provisions in this Part applied to private residential tenancies. Initially the provisions governed only new lettings of more expensive accommodation. The new Part IV did not attempt to restrict the rent of these lettings but it did give tenants the right to a new tenancy at the end of their current term. That right was qualified: the landlord could oppose the grant of a new tenancy on certain grounds, and the rent to be paid under the new tenancy was the prevailing market rent. The objective was to wean tenants off statutory protection and eventually to return all tenancies to private contract and the open market. Part IV also contained a number of disparate provisions which had little or nothing to do with security of tenure.

In pursuance of that objective, more and more previously rent-controlled tenancies were progressively subjected to Part IV. Eventually at the end of 1998, during a period of falling rentals, the abolition of rent control provided by other

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parts of the ordinance which related to long-standing residential lettings of older and less expensive premises meant that all private domestic lettings came within Part IV. The rental slump continued into 2002 when the legislature amended Part IV to imply certain terms for the protection of landlords into tenancy agreements governed by that Part. These terms were intended to supplement and repair deficiencies in those agreements. They constituted a partial retreat from the policy of giving parties freedom to make their own agreement.

The final step in the abolition of tenure controls came in 2004 when the provisions of Part IV dealing with a tenant's right to a new tenancy were repealed. This left Part IV almost a shell, consisting of the new implied terms and a number of residual sections dealing with a variety of matters of marginal importance. The rest of this chapter will examine those implied terms and the provisions which were not abolished in 2004. Before doing so, however, it is necessary to address the question: what tenancies are governed by Part IV?

Application

In the words of section 116(1), Part IV applies to 'any domestic tenancy', irrespective of whether that tenancy is written or oral. A tenancy is defined in Part IV to include an agreement for a tenancy and a subtenancy.[2]

The test of whether a tenancy is domestic is whether the premises were let as a dwelling, which is ultimately a question of fact.

There is lengthy, but not very clear, provision in section 115A for ascertaining whether a tenancy or subtenancy is domestic. This is always a live issue because of the Hong Kong habit of working and living at the same premises in order to save space and rent. Section 115A is unrealistic enough to assume that premises are used primarily either for business or for residential purposes and cannot be used equally for both. The difficulties which can arise are illustrated by a quartet of cases from the 1980s concerning ground floor shops, the 'shophouses' which used to dominate older commercial areas and which are still to be found in parts which have escaped or resisted the attention of developers.

In the first, *Chan Kwok Kwan v Chan Cheong Wai* (1980), a grocery store was the residence of the store's proprietor and his family. They used the shop area as a sitting room in the evenings. The tenancy agreement said that the use was to be non-domestic. The officers of the Commissioner of Rating and Valuation, who inspected the premises, said the use was primarily non-domestic. Yet the court thought that the use was primarily domestic.

By contrast, in the second case, *Kwong Cheung Sun v Ko Wing On* (1982), the court thought that the primary use of a ground floor shop was domestic even though the tenant ran a business there with a turnover of more than $1 million a year and claimed the rent as a business expense. The difference was that the tenancy agreement stated that the premises were for domestic use and the commissioner's staff were of the view that it was primarily used for domestic purposes.

Yet in the third, *Yu Kuk v Commissioner of Rating and Valuation* (1985), where the commissioner's staff thought that the shop was primarily used for non-domestic purposes, the Lands Tribunal was quite prepared to differ. In her shop, Mrs Yu sold drinks and cigarettes and also had tables at which her customers could consume the drinks and play mahjong. She kept stock in the cockloft but also slept there and washed in an area at the rear of the shop. She cooked, ate and

watched television in the main part of the shop. Her hours of business were short and her profit was modest. The tribunal said that it was a case of a person using her home to run a business to support herself, so the primary use was domestic.

The tribunal did the same in *Wong Yip v Commissioner of Rating and Valuation* (1985) where Mr Wong sold refreshments, cigarettes and tobacco at the shop run by himself and his family in Stanley Main Street. He used parts of the premises, such as the kitchen, to store goods but the family lived on the premises. The tribunal said that the primary use was domestic. However, the landlord appealed and the Court of Appeal had doubt as to the correctness of the tribunal's approach and conclusion so sent the case back for the tribunal to reconsider the facts using the proper approach.

What then is the proper approach? The starting point is the lease. A domestic tenancy is a tenancy of premises let as a dwelling, so we must look at the terms of the lease to see whether they declare the letting to be for business purposes or for residential purposes. If there is no written agreement, the purpose can be proved by oral evidence. Where there is a written agreement, the purpose may be indicated negatively, that is, by a restriction on use, either by a covenant against carrying on a business on the premises (or against using the premises as a residence), or by a covenant that the premises shall be used for business (or residential) purposes only.

Rather unnecessarily, section 115A goes on to declare that a term that the premises shall be used for a specified purpose shall be prima facie evidence (sufficient proof unless evidence contradicting it is offered) that the premises are being used for that purpose. However, the law looks at the reality, not the form. To prevent a landlord avoiding the application of statutory controls by using a sham business lease, it is the actual principal use to which the premises are put which determines the nature of the tenancy. There may of course be other subsidiary uses as well, but it is the primary use (or 'primary user' as the ordinance and lawyers call it) of the premises which is of first importance. Even if the lease says that the purpose of the letting is not domestic, cogent evidence that the premises are in fact mainly used for domestic purposes will override the presumption that the lease reflects the truth. Although, if use of the premises as a dwelling is a breach of the tenancy agreement, the tenant has to show that the landlord knew that the premises were being used as a dwelling and either agreed to that or tolerated it.

The safest way for the tenant to contradict the lease is to call in officers of the Rating and Valuation Department to inspect the premises and issue a certificate of primary user. The tenant may do this whether or not a dispute has arisen between him and the landlord (though a different application form is used if there is a dispute). The department's officers inspect the premises, if possible on a day requested by the tenant, and will later issue to both landlord and tenant a certificate stating what the department considers to be the primary use. The certificate is prima facie evidence of the facts stated in it and of the primary use of the premises on the day of inspection.[3]

It is possible, though unlikely, that the primary use may change between the date of inspection and the date when the landlord begins proceedings for possession against the tenant (which is the relevant date for assessing primary use). It is possible, though again unlikely, that the departmental officials have made a mistaken assessment or refuse to express an opinion on primary use because of insufficient or conflicting evidence. To guard against this, a party may apply for a determination by the Lands Tribunal of the nature of the tenancy.[4] However, the certificate is only prima facie evidence, evidence of other

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indications as to primary use may be put before the court or tribunal. Provisions in the government lease and in an occupation permit may be taken into account; so that if both or either says the land must be used for residential purposes only, this will tend to indicate a primary domestic use. Oral evidence of the actual use of the premises may of course be given by the parties or their witnesses.

The fact that a business is carried on at otherwise domestic premises does not necessarily prevent them retaining a primary domestic use. The business must be 'consistent with the domestic nature of the tenancy'[5] and this will be more likely if the business is small in scale and of a type suitable to be run from a residence, such as a service involving little disturbance to neighbours or a so-called 'cottage industry', for example, part-time sewing by members of the tenant's family. Certain criteria are nominated for assessing whether a business is consistent with a domestic tenancy. This includes: the floor area used by the business, the number of non-resident employees working at the business, the equipment, fixtures and fittings of the premises, and the gross profits from the business comparative to the rent. In the *Shirlien Light* case (1971), a piece-work sewing business which operated during the daytime was held consistent with a primarily domestic use, where the tenant and his family cooked, ate and slept on the premises and used only one of the four rooms for business part of the time.

Since the lease and the landlord might say one thing about the nature of the premises and the tenant and the occupation permit might say another, it would be natural for the court or tribunal to pay special attention to the opinion of the commissioner and his officers, who are independent of the dispute. This seems to be the case following a Court of Appeal decision in 1982, though previously considerable judicial doubt had been expressed about the usefulness of the commissioner's certificate.

The Court of Appeal decision is *Kwong Cheung Sun v Ko Wing On*, mentioned above. The tenant ran an electrical contracting business from his home on the ground floor of a building in Kowloon. The business had a turnover of more than $1 million a year, even though the net profit in the previous year was apparently only $26,000 (the gross profit is not mentioned in the judgments). There were two non-resident employees. About 38% of the floor area was used for the business. According to the lease, the original letting was domestic. The commissioner's certificate showed that the premises were used for business. The judge, however, basing himself apparently mainly on the proportion of the floor area occupied by the business, thought the primary use was domestic. The Court of Appeal said the primary use was business. The onus was on the landlord to prove that the primary use was different from the purpose of the letting, and he had done this by producing the certificate. This is not obvious from the wording of the ordinance which says that both the lease and the certificate are prima facie evidence and so they would tend to cancel each other out. However, the court was clearly impressed by the 'great evidential worth' of the certificate which was given only after a visit to the premises to measure, view and assess the overall effect of the occupancy. Furthermore, officers of the department attended court to give evidence based on notes made at the time of their inspection.

It seems therefore that the commissioner's certificate is of special value in disputes about the application of Part IV, at least where it is supported by notes of the facts on which it is based, and provided it is not out of date by the time of the hearing. Previous decisions which have held that little weight should be attached to such certificates are explicable on the grounds that in those cases, either the inspection was well before the commencement of proceedings (or no certificate

was available) or that departmental officers did not supplement the certificate with oral testimony.[6]

One of the difficulties in assessing primary use is that a business such as a restaurant, although actively conducted on quite a large scale, may be carried on for only a small portion of the day. Another business, such as storage, may not be so obtrusive, yet it may take place for much longer periods. It is difficult for the commissioner's assessment to reflect the intensity with which the business is carried on and its compatibility with domestic use. The Court of Appeal in *Wong Yip* emphasised that the tribunal should take into account the around-the-clock use of premises and the passive business use, if any, of the premises supplementary to the main or more active business use. In the same case, the court also said that because of the general policy of the ordinance is to protect tenants in occupying their homes, where there is balance between domestic and non-domestic use, the scales may properly be tilted to the domestic side.[7] This was indeed the policy until the early years of this century but as a result of the abolition of tenure controls in 2004, this is no longer the case.

The relevant date for judging primary use is not laid down in the ordinance. However, it has been suggested that it is the date on which the landlord seeks to obtain possession, that is, the date on which he serves notice to quit or issues a writ (in the High Court) or summons (in the District Court) or makes an application (in the Lands Tribunal).[8] This seems sensible, although in most cases it will not matter since the use will rarely have changed between the date of any inspection by the commissioner and the date of the commencement of proceedings.

A subtenant equally must rely on the primary use if there is a conflict between that use and the head lease under which the tenant (the subtenant's landlord) holds. So if the head lease contains a stipulation that the lease is for business purposes, or that residential use is not allowed, the premises are deemed to be used for business purposes until the subtenant satisfies the Lands Tribunal otherwise.

Use as a dwelling does not include use as a boarding or lodging house. Neither a boarding nor a lodging house are defined, but presumably they mean several rooms in a building being occupied by contractual licensees who pay (with money, or money and services) for their individual rooms or parts and, in the case of a boarding house, meals as well. In other contexts, it has been held that boarding signifies the provision of food and lodging the provision of accommodation. Although use as a boarding or lodging house is domestic, it is also commercial.[9] The meanings of 'boarding house' and 'lodging house' have been debated in a number of cases at first instance concerning whether use of premises as an old people's, or residential care or nursing, home is in breach of a covenant against use as a boarding house. Judges have taken the simple view that such places are a kind of boarding house since they are places where persons are accommodated and provided with food. However, this overlooks the additional services of care and attention (medical, nursing, health, nutritional, physiotherapy and so on) which may be provided at these homes, as well as the social need for supervised accommodation for the elderly and infirm. If the additional services and the ordinary description of the establishment in question are irrelevant and the only question is whether food and accommodation are provided to residents, then a hotel, hospital, rehabilitation centre, children's home or even a prison would be a boarding house, which is of course absurd. If the test adopted were 'would you most readily call this establishment a boarding house or lodging house or

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something else?' rather than 'is food provided?' most people would answer 'no, this is an old people's home' or a hotel or hospital or prison as the case may be.[10]

Exclusions

Having applied itself in section 116(1) to any domestic tenancy, Part IV goes on, in section 116(2), to state exceptions. Tenancies of types of land excluded from Part IV are in summary: land held from the government and other public bodies; vacant land; agricultural land; premises let to the tenant by virtue of employment (service tenancies); and premises let for a fixed term of five or more years at a fixed rent and with no provision for earlier determination by the landlord.[11]

In practical reality, these exclusions are of little impact. However, the question of whether a tenancy falls into one of the exclusions does occasionally arise, so we will examine them in a little more detail.

Part IV does not apply to vacant and agricultural land, nor to tenancies held from the government and certain other public institutions, including the Housing Authority. The object of the legislation is to apply to tenants in their homes, so tenants of farm land or land which has no building on it are excluded. However, it is not obvious why all tenants from the government, the Housing Authority and other housing bodies are denied the privileges of Part IV. A government lessee, that is, an owner of land, does not need the protection, but tenants under short tenancies from the government and tenants on public housing estates may think they do. Presumably, such public authorities are thought to be good landlords who will treat their tenants fairly. The government has not, however, denied itself and similar institutions the protection of Part IV where it is a tenant. The definition of tenant in section 115 includes a public body, so where the government rents flats from private landlords for the accommodation of civil servants, the ordinance applies.

A service tenant, who holds his tenancy by virtue of his employment, does not come within Part IV if the terms of employment require vacation of the premises when the job comes to an end.[12]

These exclusions have long been in the legislation, in Part IV and the now-abolished Part II. An exclusion which became effective in Part II and Part IV from 18 December 1981 is of a tenancy or sub-tenancy in writing which is for a term of five years or longer and contains no provision enabling the landlord to terminate it before expiry (except on the grounds of forfeiture), nor any provision for an increase in rent or the payment of a premium. It was felt that many landlords, who perhaps were thinking of retirement in five or more years, might welcome the chance of a fixed secure income from their property and the assurance that they could obtain vacant possession when they eventually decide to live in the premises or sell up and leave Hong Kong. It was also felt by some that this would be a loophole exploited by landlords and five-year terms would become popular. In the event, very few such tenancies appear to have been granted. It seems that even owners looking to retirement are not prepared to sacrifice income for security.

Effects of Part IV: summary

The most significant of the hotchpotch of matters left in Part IV after the removal of security of tenure provisions is the implication of certain terms into tenancy agreements which are subject to Part IV. Also of practical importance are the continued requirements of giving notice of a tenancy to the Commissioner of Rating and Valuation and of obtaining the commissioner's endorsement. A number of statutory powers of the commissioner were likewise retained in Part IV.

Two matters mentioned in previous chapters which owe their validity to Part IV are the requirement that the landlord provide rent receipts and the forbidding of harassment of tenants. In addition, there are sections dealing with notice and costs. Certain of these matters are expanded upon below.

Implication of terms

Since the introduction of Part IV in 1981, the approach had been to leave the parties to agree upon the terms of their tenancy. This was in contrast with the approach to tenancies falling under the now defunct Parts I or II where the ordinance implied a limited number of terms in addition to those agreed by the parties.

The Part IV policy of limited intervention in the content of the agreement worked satisfactorily when Part IV applied to newer and more expensive accommodation—the landlord and the tenant could be expected to take care of what was agreed and record that in writing. However, as old tenancies which had been governed by the older statutory provisions (or newer tenancies of less expensive property which would have been governed by the older statutory provisions) increasingly fell within Part IV, deficiencies in the contents of agreements were discovered, attracting adverse judicial comment. For example, there might be no covenant by the tenant to pay rent or there might be no power in favour of the landlord to forfeit the tenancy if the rent was not paid.[13]

In order to remedy this, it was proposed years ago that there should be a covenant to pay rent and a power of forfeiture implied by statute. By the time this proposal came to be considered by the Legislative Council, other problems had emerged for landlords who had oral, or home-made, or simple stationers' tenancy agreements. These attracted legislative sympathy, so the amendments made at the end of 2002 introduced no fewer than four terms to be implied into tenancies made on or after 27 December 2002.

These implied terms are covenants by the tenant:

- to pay the rent on the due date and a condition for forfeiture if that covenant is broken by the rent not being paid within 15 days of the due date;
- not to use, or suffer or permit the use of, the premises or any part of the premises for an immoral or illegal purpose;
- not to cause unnecessary annoyance, inconvenience or disturbance to the landlord or any other person; persistent delay in the payment of rent is unnecessary annoyance, inconvenience or disturbance;
- not to make, or suffer or permit, any structural alteration to the premises without the prior written consent of the landlord.

Each of the last three covenants is supported by an implied condition for forfeiture if the covenant is broken.[14]

None of the covenants is to be implied if there is already in the agreement a covenant substantially to the same effect as the implied term, because it is not then needed. Where the agreement does contain such a covenant but no power of

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forfeiture in the event of its breach, the ordinance implies a condition for forfeiture anyway.

These implied terms operate during the term of the tenancy. Therefore, if one or more is broken, the landlord has the option of terminating the tenancy by exercising the power of forfeiture, even though the term of the tenancy has not expired.

Payment of rent

The implied covenant to pay rent when due underpins the most elementary of the tenant's obligations. As pointed out in chapter 4, this covenant is in any event implied where rent is reserved. The statute however goes further in that it implies a time within which the rent is to be paid (within 15 days of becoming due) and reinforces the obligation with an implied power of re-entry if the covenant is not observed. Such covenants are similarly implied into business lettings governed by Part V of the ordinance.[15]

Enforcement of the power of re-entry would be subject to the law concerning forfeiture for non-payment of rent examined in chapter 12.

Immoral or illegal use

A covenant is implied that the tenant must not use, or suffer or permit the use of the premises for an immoral or illegal purpose. This covenant is commonly expressed in leases.

The best evidence of illegal use is a conviction of the tenant for an offence carried out at the premises. However, the offence must be scrutinised: it must necessarily involve the use of the premises for an illegal purpose, or there must have been evidence of such use. For instance, a conviction of the tenant for possession of dangerous drugs is ambiguous: it may mean he stored them at his home, or it may mean he simply had the drugs in his pockets when arrested. If he was arrested at the premises with drugs on his person, this would not be conclusive that he was using the premises for an illegal purpose—merely that the premises were the crime scene. In respect of convictions under the Gambling Ordinance, which can be of a very technical nature, it cannot simply be assumed that a conviction is right.[16]

If there is evidence, however, of illegal conduct involving use of the premises even on only one occasion, that is sufficient. The idea of 'use' does not involve repetition.[17] Illegality in this context seems to mean forbidden by law, a breach of the criminal law—that is doing an act which is punishable, rather than just discouraged. For instance, not all bookmaking is illegal, although all wagering contracts, whether arising out of criminal gambling or not, are void and against public policy. Although this second kind of gambling is 'illegal' in the sense that it is not recognised by law, it is not illegal in the sense suggested by the ordinance. Similarly, it is suggested that using the premises for a generally acceptable purpose which happens to be forbidden by a clause in the lease (for instance, running a business where the premises are to be used for domestic purposes only) would not be an illegal use for purposes of this ground for possession, though it might be said to be illegal in the wider sense of being a breach of the lease.

Immoral use is a wider and less defined concept than illegal use. The authorities are sparse, presumably because most uses which are regarded as

immoral are also illegal. 'Immoral' seems to add little. It may be that the words 'immoral or illegal' are meant to be read together, as 'immoral and illegal'. Ultimately, the tribunal would have to judge what is and is not immoral.

'Suffering or permitting', although commonly found in covenants against illegal use in tenancy agreements, is phraseology imported from the criminal law. Both actions require knowledge of, or at least suspicion about, the illegal use on the tenant's part; although 'suffering' perhaps suggests that he did not like the use, whilst 'permitting' suggests he was indifferent to or encouraging it. Knowledge can be inferred from the surrounding circumstances. Permitting also seems to involve the tenant either approving the use, or not taking reasonable steps to prevent it. A tenant who is aware of the illegal use by another occupant, yet does not sue to prevent it, may be held to be permitting, or suffering, that use. However, it depends on the circumstances and it is unlikely that a poor, uneducated or elderly tenant would be dispossessed simply for failing to sue his subtenant or licensee who is using part of the premises for bookmaking or storage of heroin. Consistent protest to the occupant about his conduct, requests for him to leave and refusal to accept rent would in these circumstances appear to be enough.[18]

There is an overlap between this covenant and the covenant concerning nuisance which will be dealt with next. There are illegal uses (such as the storage of drugs) which the tenant would be anxious to keep from the attention of others, so illegal or immoral use would be relied on alone. On the other hand, the classic instances of illegal use (gambling, prostitution) will usually involve at least some inconvenience or disturbance to neighbours.

Nuisance

Section 117(3) also gives the landlord the benefit of an implied covenant against the tenant causing unnecessary annoyance, inconvenience or disturbance to the landlord or any other person, if the agreement does not already contain an express one. This may be referred to as the 'nuisance ground' although the wording of the paragraph is wider than nuisance, which at common law involves the causing of discomfort to adjoining occupiers. Annoyance and inconvenience can result from something less than nuisance and, whilst what constitutes a nuisance would vary with the neighbourhood, it may well be that inconvenience and annoyance is a question of fact: was the complainant inconvenienced or annoyed? Certainly the covenant is not confined to annoyance caused to immediate neighbours or even other tenants in the same building. It might be that the tenant persistently annoys residents of nearby buildings by making excessive noise late at night, throwing objects out of his windows and so on.

The annoyance and inconvenience can also be caused to the landlord. The most common example of such inconvenience would be a persistent failure to pay rent when it is due: this is specifically mentioned in section 117(5) as being unnecessary annoyance, inconvenience or disturbance. Similarly, persistent late payments of other amounts which the tenant is obliged to pay under the terms of the lease, such as management fees, might cause inconvenience. Another example of inconvenience to the landlord would be repeatedly telephoning him and demanding that he come to carry out repairs which are not his responsibility. Indeed, all cases of harassment of landlords by tenants would fall within the covenant.

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