Hong Kong Contracts
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General Editor's Foreword

Times are changing for professional education as for all else in Hong Kong. The Hong Kong Society of Accountants has recognized the need to bring its educational demands home to Hong Kong and forward to the present day. All the law parts of the professional examinations now require the student to know the law in Hong Kong rather than England. Before the Society could make those changes it had to be confident that students had appropriate textbooks from which to study Hong Kong law, and so it asked the members of an advisory committee on law studies, who represented institutions teaching accountancy students, to write introductory monographs. There are five: on business associations, cheques, goods and professional liability as well as this, on contracts. Their purpose is primarily to help students taking the professional accountancy examinations but we, the authors, hope that they will be of more general use as introductions to parts of the law which people in Hong Kong would like to know more about.

The other books in the series are:

Business Associations by Clement Shum
Goods by Judith Sihombing
Hong Kong Contracts by Carole Chui and Derek Roebuck
Professional Liability by Robert Wickens

All will be published in revised Second Editions by the Hong Kong University Press in 1991.

Derek Roebuck

July 1991
The aim of this book is different from the authors’ other books on contract law. It sets out to provide beginners in Hong Kong with a straightforward text to help them in their first studies of the law of contract. In particular, it recognizes the need of the many students who aspire to become accountants for a book specially written for them.

This book is not a diluted legal textbook, trying to cover everything a lawyer needs to know and somehow hoping that a beginner will be able to understand the difficult parts without the depth of explanation that a legal textbook has room for. We have taken into account the readers’ starting point and how much time and effort they can sensibly be expected to spend on this subject before moving on to other legal topics covered elsewhere. We have taken advantage of the existence of other books in the series which cover some topics in depth which we would otherwise have had to include. We have numbered the paragraphs and sub-paragraphs and all references are to those numbers and not to pages. We have ended each chapter with Points to Note, to help readers to understand and to check that they have understood.

We thank the many students we have taught, of accountancy, companysecretaryship, business and management, building, arbitration, as well as law, who have helped us to clarify our ideas and taught us how to communicate them. We also thank our colleagues Sheree Leung and Rosita Chan, who have managed us, our manuscripts and many drafts.

A new edition is needed to take account of important changes in the law in the last two years. Legislation has reduced the age of majority to 18 and improved consumers' rights by the control of unfair terms. Recent cases in Hong Kong and elsewhere have developed the law. The opportunity has been taken to correct misprints and improve expression here and there. Though Carole Chui is now with the College of Law in England, we remain jointly responsible for this edition.

Carole Chui
Derek Roebuck

July 1991
Chapter 1

What Contracts Do

1.1 Contracts and Other Obligations

People need to be able to deal with one another in ways which change their mutual legal obligations. We all have duties and privileges, arising from convention or from our status, for example as parent, child or citizen, but they do not provide us with all we need for our daily lives.

Now it is obvious that many needed things are provided not by contractual arrangements but in some other way. One source is the family. Parents are not bound by contract to look after their children in any society. The reason they feed and clothe them is not that they would otherwise be subject to prosecution. They do it because they are parents, because of the relation between them and their children, but a relation of status not of contract. In most parts of the world, children are educated not by contract but because the state has taken over that responsibility. Their education arises out of their relation with the state, which is a matter of status. Some are still privately educated and a contract to some extent governs the relation between school and pupil. What is done by contract in one country is a matter of status in another. Medical treatment is a matter of private contract in some societies, in others it is provided by the state. It used to be the same with fire services and now in many countries businesses must buy private security services, a job which even the classical libertarians allowed to be the exclusive responsibility of the state.

If we have a party and invite friends who say they will come, we can normally be sure that our efforts will not be wasted, because we know that, even if at the time it is inconvenient, they will feel bound to honour their commitment. But we do not consider them bound by contract, nor is it a question of status, because friendship is not a relation recognized by law. If they find that they prefer not to come on the night, the bond between us arises perhaps out of feelings of ethical compulsion, perhaps out of fear of some social
sanction for failing to conform. Very little may appear to happen to those who habitually break social conventions. Yet all these influences which impel us to behave in a certain way are powerful, some much more powerful than any contract could be; but they are not contractual ties.

Nevertheless, we all need something more: contracts. Those involved in business in particular must be able to bind themselves to act in ways in which they need not have acted without this new bond that they create for themselves. Conversely, they must be able to rely on others (who have bound themselves to them) to act in a certain way at a certain time. The planning of their future action rests on their being able to depend on contracts.

1.2 The Functions of Contract

What purpose then does contract serve? The typical purpose is a commercial one. The amount of contract and its spread through a society largely depend on the amount and spread of commercial activity. People in business need to depend on others doing what they have undertaken to do and on the state either forcing them to do it if they refuse or making them pay compensation, a sum of money called damages.

If you think for a moment about modern everyday business activity you will see that making contracts and doing business go together. Consider a simple model of a business. When about to start commercial or industrial activities, a man or woman will choose either to be the sole proprietor or to join with others in some way by means of contracts. If they take a partner, their relations will be governed by a partnership agreement. If they form a limited company, there will be contracts between the company and each shareholder, and between the company and each director. If they are agents, the relations with their principals will be governed by contracts. The business will need premises, bought or leased by contracts. The employees will have their contracts with the company. Machinery and other plant will be bought, or taken on hire-purchase, or hired. Raw materials will be needed, and not only will supplies be bought to meet immediate needs, but careful business people may try to ensure supplies well into the future by means of contracts. Similarly, they will not only make contracts to sell what
they have made, but also enter into long term contracts to make sure that they have enough orders for their goods for a reasonable time ahead. They may have to enter into contracts with customers under which they are responsible for servicing the product, or guaranteeing it for a period. They will make contracts with carriers to transport their goods. Carriage contracts are highly developed and complex, particularly if the goods are going abroad, whether by land, sea or air. In connexion with these goods and also to protect the business against fire, theft, liability to claims for all kinds of negligence, loss of profits, workers’ compensation, and many other possible losses, they will enter into contracts with insurance companies.

So far it has been assumed that those engaged in business have enough money of their own or money contributed by partners or shareholders. This will rarely be so. They will open a current account with a bank, an act which itself creates all kinds of contractual obligations between the customers and the bank, which are implied into the relation which exists once a current account is opened, and which have accumulated over three centuries.

What has been described is a simple model. The more complex the business the more contracts, and the more kinds of contract, are used. In particular, the provision of finance and credit has produced the greatest sophistication of the contract device. Economic growth depends on finance being made available. Although all governments now control to some extent the supply of finance in their countries, from both internal and foreign sources, there is still need in non-socialist countries to encourage private lenders, that is lenders who are not governments or government institutions of some kind, to lend their money. The provision of adequate contract arrangements is one of the factors which act as an inducement. The basis of wealth in modern societies is the contractual promise. Most kinds of wealth are contractual rights: bank accounts, shares in companies, debentures and other loans and most forms of security.

1.3 The Basis of Contract

From one point of view, the basis of contract is reliance. A contract may allow the parties to rely on getting some future benefit; to some extent to control their future. By making contracts, parties hope to reduce the uncertainties of life. The possible intervention and super-
vision of the state encourage them to rely on the fulfilment of their expectations. This is of the greatest importance for another reason. It persuades them to be content with the order which the state provides and to forgo self-help.

A well worked out system of legal principles, ready access to the courts, responsible, sensitive and practical judges, competent lawyers, ethical business people and a stable economy, were they ever to co-exist, would guarantee the smooth working of this model. But contract law may have many faults, a legal system may be expensive and dilatory, lawyers may be half learned and judges remote, business people may be piratical and the economy chaotic. The law of contract in Hong Kong has not only to lay down rules which guide those who make contracts so that disputes can be avoided, it must also provide solutions for those disputes which inevitably arise.

**Points to Note**

1. People in society have mutual obligations. Some arise from contracts; some arise from status and some in other ways, e.g., friendship or social arrangements.

2. Business requires legally binding agreements, i.e., contracts.

3. Planning rests on reliance on behaviour of others, bound to behave in the expected way because the state enforces contracts.

4. Business contracts take many forms and permeate all business activity.

5. Wealth consists largely of contract rights.

6. Adequate contract law induces investment.

7. Adequate contract law, enforced effectively by the state, induces the parties to forgo self-help.

8. The law of contract has a twofold task: to prevent disputes between the parties and to resolve those it cannot prevent.
Chapter 2

What the Law of Contracts Does

2.1 Introduction

For legal purposes, the word ‘contract’ means in English an agreement which the state will recognize as legally binding. If an agreement is not legally binding in this sense, then it is not called a contract.

Without a law imposed by the state, the relation itself is quite different, because the parties behave differently if they have to rely on custom or social pressure or self-help and cannot call on the state to impose its sanctions. Moreover, because contract has throughout its modern growth been seen as a technique for allocating risk between the parties — which is one of its major functions if it is made by business people — it has been accepted policy that the law should be as certain as possible rather than aspire to changing standards of fairness. That policy has always been mitigated to some extent by judges determined to do justice between the parties and has been relaxed in England in the last decade or so. To a greater or less degree in other common law countries great changes have been made by statute and by the innovations of the higher courts. Few such changes have taken place in Hong Kong, which is in danger of being governed by a superseded model of English law. But it is the law in Hong Kong which is described in this book. Every separate legal jurisdiction has its own distinctive law. The law of contract in Hong Kong is very like that of England but the subtleness of the differences make them all the more dangerous and therefore all the more important for the student, the lawyer, the accountant and all those in business to be aware of.

Most of Hong Kong’s contract law cannot be found in legislation. Very few ordinances deal with contract principles, which can only be discovered by skilful reading of thousands of reports of cases decided not only in Hong Kong and England but in other common law jurisdictions. The following chapters try to distil the law in those cases into intelligible principles.
The purpose of this chapter is to present a picture in outline only, of what functions the law of contract performs, to give you a framework in which to place the ideas of all the later chapters where the law is divided up into different topics. The functions of the law of contract are dealt with under five heads, just to make explanation easier. First, it must be decided whether there is a contract at all. If there is not, then that is the end of the enquiry. But if there is, then the next question is ‘what does it mean?’ or ‘what is its effect?’ The contract may have flaws that prevent it working properly or even prevent it coming into existence or staying valid. It may be necessary to find out who is involved, who are the parties and whether anyone else’s interests affect or are affected by the contract. Lastly, what happens if it is broken?

2.2 **Is There a Contract?**

This is a question of law, and it may be answered by the parties themselves agreeing that there is, or accepting the advice of their lawyers, or, if legal proceedings are begun and the case comes to trial, by the court. A court can only decide a case on the evidence presented to it. Judges can only determine whether a contract has been made by considering the evidence before them, provided by the witnesses for the parties, usually including the parties themselves, as to what the parties did and wrote and said at the time they were negotiating for a contract. The judge is concerned with what they did rather than what they now say they meant to do. To the judge hearing a contract action, agreement consists of acts (including words) and the state of mind of a party is relevant only exceptionally. Judges will decide that a contract has been made only if they have before them legally admissible evidence showing the parties’ willingness to be bound to one another. The parties must have exhibited some intention of making use of the authorization given by the state to those who wish to change their legal relations with one another by contract. Judges must be satisfied that each party manifested a willingness to be bound to the other party on terms agreed between them.

A typical contract arises out of negotiation between the parties and comes into existence when, after one party has manifested a willingness to be bound on terms which he or she proposes, the
other party shows assent to the contract on those terms. This process is usually characterized in the following way: the offer by one party, called the offeror, gives to the other, called the offeree, the ability to create a contract by making known acceptance to the offeror. However, it is now recognized that agreement can be manifested by the parties in other ways. In the process of negotiation there may be many stages, invitations, offers, counter-offers, rejections and acceptances.

All systems of law need a method of distinguishing agreements which it is proper for the community to enforce by the application of its sanctions from those which it should not. In earlier forms of society great stress was laid on formalities, and many modern systems of law, including the common law, retain traces of this attitude which are still important. Common law still has the deed, whose effect is dependent on its form. It also requires contracts for the sale or other disposition of an interest in land to be supported by written evidence.

It does not say there is no contract without writing, merely that writing is the only kind of evidence the court may accept, though even this is subject to many exceptions. The language of this part of the law draws a distinction between enforceable contracts, of which there is evidence that the court will accept and which the courts will therefore enforce, and valid contracts which are binding but which, because they are not evidenced in writing, the court may recognize but must refuse to enforce. But the policy of granting the greatest possible freedom to exercise economic power, a policy which gains strength with the growth of capitalism, also encourages the discarding of requirements of form, except in exceptional situations. Therefore, whether it is characterized as freedom of contract in the common law or as autonomy of the will in the laws of other countries, there is a policy not to require formality for validity or enforceability.

If not some solemn form or token, then what test will distinguish agreements recognized and sanctioned by the state, for that is what contracts are, from other kinds of agreement which the law will not treat as binding? In the common law it is consideration: promises are enforced not because it is wicked to break a promise seriously made, or a promise intended to be binding at law, or a promise intended to be relied on, or even a promise in fact relied on by the promisee, but because one person, who has done or promised
to do something for another in reliance on that other’s promise, can properly expect the other to carry out his or her part of the transaction. In other words, A may expect the law to ensure that A’s legitimate expectations aroused by B’s promise are fulfilled, but only if A paid a price for B’s promise by doing something (including making a promise) in return. The basis of the common law of contract is bargain. A party who wants to enforce a contract must show that he or she has given consideration. If A says to B ‘On your twenty-first birthday I will give you $100,000 to set you up in life’ and B says ‘Thank you, I will be able to rely on your promise and plan my future accordingly’, there is certainly an agreement between them. But there is no contract at law. That is not because the agreement is not intended to be binding, for it is and by both parties, but because B has not given anything in return for A’s promise. Each party to a contract must give something (which may be a promise) to the other in exchange for what he or she gets. It is no contract if one party takes rights without incurring corresponding duties. But consideration is not necessary if the contract is by deed.

The history of the deed is different from the history of contract. The deed takes its legal effect from its form. In Hong Kong it still must bear the seals of those who execute it, though the requirement is vestigial. It must also be signed and witnessed. There are other requirements about what is called delivery; so that a deed needs to be signed, sealed and delivered.

Moreover, it is possible to make a gift of a tangible object, which will be binding without consideration. It is the promise which is not binding without consideration, not the transfer of property. If in the last example A had given B the $100,000 forthwith, handing over the money, A could not have recovered it. B would have become the owner on delivery. In legal jargon, property would have passed. But if the subject matter is of such a nature that delivery is not possible, such as a promise, then a deed must be used.

2.3 What is the Effect of the Contract?

Even where there is satisfactory evidence that there is a contract, even where the parties agree that there is a contract, they may disagree about what it means, what its effect is. Their disagreement may be about what terms are in the contract. Or they may agree on
what terms are contained but disagree about their meaning or relative importance. One party may say that there is a term not expressed in the contract, but which both parties understood would apply, and which the court ought to imply. The other party may deny that. Such an implication can arise from a previous course of dealing between the parties, or because such a term is customary in their trade, or sometimes because legislation implies a term into that sort of contract. Occasionally it may be possible for a party to show that the contract so obviously needs a term implied into it, if it is to make sense, that the parties must have left it out inadvertently. Express terms displace implied terms which conflict with them. Terms implied by legislation are quite common. Sometimes an ordinance says that a term is implied unless the parties agree that it should not be; sometimes the term is imported whether the parties like it or not.

The evidence may show that a contract was made in writing, or orally, or by conduct of some other kind, or by any combination of these methods. If it is completely contained in written documents, then the task of finding its meaning will be performed by the judge, who will interpret the documents; if it is not, then evidence will have to be adduced to show what was said and done.

It is not always easy to decide whether something which was said during negotiations has become a term of the contract, whether it was a promise or something else. If it was a promise and it has been broken, then the court will make the promisor either do what was promised or compensate the disappointed promisee. If it was not a promise, there may be nothing the promisee can do about it, unless there is proof that the promisor was fraudulent. By the time of the action, the parties are unlikely to have an accurate recollection of what was in their minds at the time of the negotiations, nor are they likely to agree, if their different interests depend on opposite interpretations. For example: A agrees to sell his car to B for $28,000 and, during the negotiations, A tells B that the car is a 1987 model. After she has bought the car, B discovers that it is a 1986 model and worth $5,000 less. If A made his statement of the car’s age fraudulently, and B can prove it (which is not likely), then B will be able to recover damages from A, and it may not matter whether the statement was part of the contract or whether it was a promise or not. An action will lie in tort — that is, for a civil wrong independent of contract. But if B cannot prove that A was fraudulent or negli-
gent, she can get damages only if she can satisfy the court that A’s statement of the car’s age was a promise. The court looks to the intention of the parties. Did they intend it to be a promise? But when the judge asks the parties what their intentions were, A will insist that it was no promise and that all he did was to tell B what date appeared in the certificate of registration. B will say that of course it was a promise. The value of the car depended on its age, and she considered A’s statement vital. She relied on A’s description, she was entitled to do so, and she would not knowingly have bought a 1986 model at any price.

The truth is that neither party had any intention which the judge could ever discover. It is only possible in many situations for the parties to have an intention one way or the other when told by a lawyer the distinction between a statement which is a promise and one which is not. They will certainly have been told that by the time they get into the witness box, but that is not likely to lead to the truth coming out. Many techniques for resolving disputes are similarly based on the court’s search, real or supposed, for the intention of the parties. Judges generally prefer to rely on what is called construction of the contract — the search for its meaning in its own words and the circumstances surrounding its creation — rather than impose their own view of what would be a fair solution. In Hong Kong, since the Misrepresentation Ordinance (Cap 284), whether the purchaser can recover damages no longer depends on whether A’s statement was a promise or not. Where that Ordinance applies, damages may be recovered even for an innocent misrepresentation.

2.4 Defective Contracts

The contract may suffer from any number of flaws, sometimes called vitiating factors. These may be of greater or less importance and the law may give them different effect. Misrepresentation, we have just seen, may allow the victim to refuse to go on with the contract, to ask the court to set it aside, or claim damages. Fraud is an even more obvious source of similar remedies, though it is hard to prove. Parties cannot enforce contracts which they have forced on others by physical threats, known as duress, or by exercising some improper control, called undue influence. It will not usually be possible to get out of a contract by pleading that you made a
mistake. The other party is entitled to your performance according
to the terms you appeared to agree. Of course, if it is illegal to make
the contract or to perform it, the court will not accept it as valid and
there are other kinds of contract, which are said to be against public
policy, which the courts will not enforce.

Though the general principle is that all contracts agreed to
freely by the parties should be enforced by the courts on behalf of
the state at the suit of either party, there are exceptions, and certain
kinds of contract and certain kinds of person have been treated by
the courts as in some way disqualified from that enforcement. Some
of those limitations have been imposed by ordinance, others by
common law. Legislation or common law may make a contract
void, or may declare it to be illegal. For centuries gambling agree-
ments have been affected in this way. More recently the government
has attempted to control such activities as building, dealing in cer-
tain exports, practising as a lawyer or accountant and many other
forms of business activity, by requiring operators to be licensed.
Trading with the enemy, corrupting officials, contracting to buy
knighthoods, even contracts to commit a sexually immoral act, have
all been affected in various ways by the common law’s unwilling-
ness to enforce them. Detailed rules have been laid down against
that infringement of liberal economic morality, the contract in re-
straint of trade.

If the activity itself is prohibited by legislation or considered by
the courts to be against public policy, then a contract to do it cannot
be made effectively. If however the ordinance provides that an
activity cannot be carried on without a licence of some kind, or
without paying a fee to the government, is the validity of a contract
affected? Sometimes the ordinance will itself say what is to happen
but more often the court has to try to find an intention. A material
factor is whether the sole purpose of the prescribed fee is to increase
the revenue, in which case a contract will be valid even if the fee is
not paid (though a fine may be incurred), or whether the prohibition
was intended to protect the public against those who fail to comply
with the legislation. Even though the policy of the law has been to
ensure the widest freedom of contract, which might in general mean
licence to exploit superior economic power to the full, the objects of
that exploitation must be persons of mature age and competent
understanding. In Hong Kong the age of majority has recently been
reduced to 18. An infant (or minor) is one who has not reached the
age of majority. Together with the mentally sick and the drunkard, infants are given special protection by being treated as incapable of making promises which bind them at law, except for the purchase of necessary goods and services. The common law also used to protect married women, in particular from the depredations of spendthrift husbands, but that protection — or disablement — has been removed by legislation. The limited company was also considered to need special privileges, and one of its characteristics is that it can only make binding contracts for purposes set out in its memorandum of association, and through officers duly appointed. Within these limits, though, any person, whether a natural person or a person created by law like a limited company, can contract validly.

2.5 Whom Does the Contract Concern?

Even when it is clear that there is a contract, it may not be agreed who the parties are. Only a party to a contract can sue on it. We have seen that a contractual promise is binding only if a price has been paid for it. It does not logically follow that only the person who paid the price can sue on the promise. Yet the courts have held this to be so. The doctrine of privity of contract is twofold: only a party to a contract can sue or be sued on it; only a person who has given consideration (or a joint promisee) is a party for this purpose.

Such a rule demands exceptions for the smooth working of business. The most important is the negotiable instrument: bills of exchange, promissory notes, cheques and some other commercial documents can be sued on not only by the original parties but by those to whom the instrument has been properly transferred. Moreover, parties have always been able to deal through agents in such a way as to become liable themselves on contracts their agents make for them, while often the agent is not. Such principals can sue on the contracts in their own names. It is clear, then, that persons other than the original parties to a contract may be involved; and a party, once the contract has been made, may assign rights under it or declare that they are held in trust for someone not a party to the contract, who will then be able to make the party who has declared the trust safeguard those interests.
2.6 **What Happens if the Contract is Broken?**

How does the law protect the rights of the parties to a contract? What happens if a party does not get what was bargained for? These questions are perhaps the most important for an understanding of the functions of the law of contract. When one party believes that the other has broken the contract, there is a range of possible responses. She can put up with it. That is what happens all the time. The matter may be trivial or the damage slight and not worth worrying about. Or her lawyer may advise that she has not got enough evidence to satisfy the court. Or she may decide that it would cost too much to go to law, or the other party is too good a customer, or it would look bad for her or affect her credit rating. Whatever the reason, she decides that it makes good commercial sense to do nothing.

Alternatively she may decide at least to try to negotiate some response from the other party. If her complaint is that she bought a faulty television set, she may ask for it to be replaced or repaired and the supplier may agree, though those are not remedies she could demand by law. If she gets nowhere, perhaps her lawyer can negotiate better on her behalf.

Another response may be to ask a third person to mediate. Or the contract may provide for disputes to be submitted to arbitration, that is to the decision of an independent expert. Sometimes it is possible to use a bit of self-help. She may have agreed to sell her car but the buyer, when delivery is due, cannot pay. She can then just refuse to deliver. If he has paid a deposit, she can refuse to repay it and he must then decide what to do about that. Of course she must be careful not to go too far and commit a criminal offence or cause him unjustified damage.

If she has performed all her part of the contract, say by delivering the goods, she can sue for the price. If the contract says that a debt has arisen, she can sue for the debt, for example, the rent of a flat or repayment of a loan.

But the ordinary and ever-present remedy for breach of any contract, whether the breach is large or small, is damages to compensate the disappointed party for the loss of the bargain. There are very few general rules in the law that can be stated without qualification. This is one: when a contract is broken the injured party has a
right to damages. If the injured party can show no loss, the damages will be nominal, a small amount awarded by the court just to show that the right under the contract has been recognized. But normally a breach causes a loss, and the loss can be proved, and then the court attempts to fix the damages at a figure which will compensate for the failure to perform the contract.

It may well be that damages are a poor substitute for performance of the contract and the party injured by the breach would much rather have the court force the party in breach to perform the contract. The old common law courts could not do that, but the courts of equity did. In Hong Kong the jurisdictions of both kinds of court are exercised by a single system of courts and any court can grant the remedy of specific performance. But it will not do so on every breach. Like all equitable remedies, specific performance is discretionary. The court will only grant it, instead of or in addition to damages, if it can be shown that damages are not an adequate remedy, that the injured party has acted equitably, and that the court has the machinery to see that its order is carried out. It will not force a person to perform personal services.

If the breach of contract takes the form of an act which the contract forbids, such as using premises for industrial purposes where the contract requires that they be kept as residential, then the court can make an order forbidding conduct in breach of the contract. This order, called an injunction, is also an equitable remedy, and within the court’s discretion.

It is vital to remember, however, that a law of contract is needed not only to resolve disputes and to ensure that the parties get their contracts performed or compensation for their loss, but also to make clear to the participants the rules of contractual relations. All members of society must have not only a system whereby their disputes can be heard and resolved, and their agreements can be enforced, but also a body of legal rules by which they can regulate their conduct so that they can avoid disputes as far as possible. The law itself has an important educational role.

This chapter has given you an overall view of the functions of the law of contract. Lawyers must know all about all its parts. You, as a beginner, need not and we have selected only the most impor-
Points to Note

1. A contract is a legally binding agreement.

2. An agreement which the state will not recognize is not a contract.

3. Contracts allocate risk. Therefore their usefulness, particularly in business, requires that their meaning be as certain as possible.

4. If contract law is to be respected, it must produce a just result.


6. The law of contract in Hong Kong is based on and similar to English law but it is not identical. The differences are sometimes subtle but always important.

7. Most of Hong Kong’s contract law is found not in legislation but in the reported decisions of the courts in Hong Kong and other common law jurisdictions.

8. The first question is ‘Is there a contract?’ That is a question of law, which depends on the intentions of the parties, as decided by the Court, on the evidence.

9. The Court must be satisfied that the parties manifested a willingness to be bound together by contract.

10. Agreement usually arises from negotiation.

11. Negotiation can usually be divided into invitations, offers, counter-offers, rejections and acceptances.

12. No formalities are usually required, but note deeds and contracts for the sale or other disposition of interests in land.

13. An unenforceable contract is one which the court may recognize but will not enforce.
14. The basis of contract in the common law of Hong Kong is bargain not promise. The party wishing to enforce an agreement must show consideration has been given for the other’s promise.

15. No consideration is required if the promise is in the form of a deed.

16. The terms of the contract may be express or implied.

17. Express terms displace implied terms which conflict with them.

18. Terms are promises, to be distinguished from misrepresentations.

19. A contract may suffer from different kinds of flaws, providing different remedies: fraud, misrepresentation (innocent or negligent), duress, undue influence, mistake, illegality, or incapacity of a party.

20. Only a party to a contract can sue on it.

21. The holder of a negotiable instrument may be able to sue on it though not originally a party to it.

22. Agents may make contracts for their principals, which bind their principals but not them.

23. Contractual rights can be held in trust.

24. Some contractual rights can be assigned. Contractual obligations cannot.

25. If a contract is broken, a disappointed party may do nothing, negotiate, use self-help, seek arbitration or mediation, or sue.

26. Remedies provided by the court include actions in debt, for the price, for damages, for injunction and for specific performance.

27. Every breach of contract gives a right to damages.

28. Equitable remedies are discretionary.
Chapter 3

How Contracts Are Made

3.1 Intention to Create Legal Relations

3.1.1 Finding the intention. To find out whether the parties intended to make a contract, the Court has to consider the available evidence. A plaintiff who wants to bring an action in contract has to take on the burden of proof. That means it is up to the plaintiff to prove the facts on which the claim is based. One of the necessary elements of a contract is an intention to create legal relations and it is up to the plaintiff to show that both parties intended their agreement to have legal consequences.

3.1.2 Presumptions. The plaintiff may be helped by a presumption. The cases show that courts have different expectations, depending on the nature of the agreement. If the agreement relates to a family matter or a social arrangement, the Court will presume that the parties did not intend to make a contract. If the agreement concerns a commercial transaction, the Court will presume it is intended to be a contract. If it is some other kind of agreement, no presumption will be made and it will be up to the plaintiff to take on the usual burden of proving the intention of the parties to create legal relations, that is to make a contract.

3.1.3 Family and social arrangements. Even now, when many women earn more than their husbands, it is not uncommon for a husband to arrange with his wife to pay her an allowance. Or parents may agree to pay their child an allowance while she is a student. If the husband, or the parents, change their minds for whatever reason, the wife or the child will not be able to bring an action for breach of contract. Why? Because the parties never intended to make a contract. They had no intention to create legal relations. How do you know? Because of the nature of the agreement. Such arrangements are not
intended to be legally binding. Of course they can be made binding. The parties can, if they wish, enter into a contract, so worded that it shows they mean to be legally bound. But if they do not, the nature of the agreement, the surrounding circumstances, show that no contract was intended. But what if the husband and wife quarrel and decide to live apart? The wife threatens to sue for divorce. The husband agrees to pay her maintenance. They go to a solicitor and draw up an agreement. Is that a contract the court will recognize and enforce? Of course it is. What if they are just estranged, but still living together, and the agreement is oral and kept secret between them? Then, perhaps, the case will fall on the borderline. That is what makes law interesting. Real problems arise like that.

In Balfour v. Balfour [1919] 2 KB 571, Mr Balfour agreed to pay his wife an allowance. At that time there was no quarrel between them but they were going to live apart because Mr Balfour’s job took him back to Sri Lanka and Mrs Balfour was too ill to go with him. When he did not pay, she sued him for breach of contract. The English Court of Appeal held that there was none. There was no intention to create a legally binding agreement.

In Merritt v. Merritt [1970] 1 WLR 1121, Mr Merritt had left his wife and was living with another woman. Mr and Mrs Merritt met to discuss their futures. He promised to make a monthly payment to her. She promised to pay off the mortgage. She got him to sign a paper saying that when she had paid off the mortgage he would transfer his share of the house to her. She did as she promised but he refused to transfer his share. The English Court of Appeal held that he intended to make a legally binding agreement, that he had entered into a contract, to transfer his share and ordered him to do so.

Times change and cases decided in one country do not necessarily apply in different circumstances in another. Mutual expectations of wife and husband, and of parent and child, also alter with time. The point to remember is that the plaintiff who wants to show that a family or social arrangement is a contract must prove an intention to create legal relations. That burden of proof is difficult to discharge if the evidence shows that the agreement was made in jest, or is of its nature uncontractual, like the acceptance of an invitation to dinner or to play amateur sport.

3.1.4 Commercial transactions. It is unusual for a business agreement
not to be intended by the parties to be a contract. Not unheard of, but not the usual intention. If I agree to buy your car and then refuse to take delivery, and you bring an action against me for the price or for damages, although you are the plaintiff and you must prove your case, the Court will not require you to prove that our agreement was intended to create legal relations, to make a contract. Why? Because commercial agreements, such as one to buy and sell a car, are presumed to be contracts. It will be different, of course, if you can produce an agreement showing we agreed that our agreement should not be legally binding — ironically called a ‘gentleman’s agreement’ — or that we spoke in jest.

In *Rose and Frank v. Crompton* [1925] AC 445, the American plaintiffs and the English defendants both dealt in carbon paper. They and a third party signed an agreement under which the plaintiffs got the exclusive right to sell the defendants’ carbon paper in the USA for three years. Cartels were illegal by US legislation. So they put in this clause:

This arrangement is not entered into, nor is this memorandum written, as a formal or legal agreement and shall not be subject to legal jurisdiction in the law courts either of the United States or England, but it is only a definite expression and record of the purpose and intention of the three parties concerned, to which they each honourably pledge themselves with the fullest confidence — based on past business with each other — that it will be carried through by each of the three parties with mutual loyalty and friendly co-operation.

The House of Lords held that their business agreement was not a contract, just because the parties had said they had no intention to create one. The intention was plain and there was no reason why the court should force a contract on parties who do not want one. But in *Edwards v. Skyways* [1964] 1 WLR 349, no such intention was found. There was a commercial agreement. The defendants wanted to terminate the contract of employment of the plaintiff, a pilot. He was a member of a pension fund. Under its terms he could either take his own contributions back when he left that job or he could wait until he retired and then take a pension. The defendants promised him, if he would agree to be made redundant and take the lump sum, to pay him the equivalent of the employers’ contribution. They
phrased their promise ‘pilots declared redundant and leaving the company would be given an *ex gratia* payment, equivalent to the company’s contribution.’ The company changed its mind and refused to pay the *ex gratia* payment and the employee sued. The court, in the English Queen’s Bench Division, held that the promise was binding. There was a contract to make the *ex gratia* payment. *Ex gratia* was held to mean that the party agreeing to pay does not agree that it was bound to pay but binds itself from then on, to reach a settlement or avoid a dispute. In this case the defendants said that all those concerned had agreed to use the words ‘*ex gratia*’ to stop the agreement becoming a contract. They said that would avoid the plaintiff having to pay tax. The court held that there was no evidence to show that was in the parties’ minds when they made the agreement. There were five or six representatives on each side when the agreement was made. The meaning would have to be sought in the words used and they were not clear evidence to rebut the presumption of an intention to create legal relations where the transaction was commercial.

3.1.5 *Other agreements.* If the transaction is neither commercial nor family or social, then there is no presumption. The plaintiff has the usual task of proving an intention to create legal relations, like any other element of the claim. Governments may make binding contracts and the Hong Kong Government makes many every day. Some are ordinary commercial agreements and the usual presumption applies. But sometimes the Government declares an intention to act in a certain way. Those to whom that declaration is made may rely on it and act on it to their cost. Can they sue if the Government changes its mind? Did the Government intend to make a contract? If the declaration of intention is a broad policy statement then the Government can be assumed to want to retain its discretion to change its policy. Even where the declaration was made to one company, it may still not be intended to create legal relations. During World War I the British Government assured the owners of a Swedish ship that it would be allowed out of the British port if it had brought in goods the Government wanted. Twice it delivered such goods and left port without hindrance. The third time it was stopped. The English Court of Appeal in *The Amphitrite* [1921] 3 KB 500 held there was no contract. The Government could not be held to have intended to bind itself in contract.
3.2 Agreement

3.2.1 Consensus. The party wishing to prove the contract must be able to prove that there was an agreement. That agreement is found not by psycho-analyzing the parties but by looking at their actions, what they have said and written and done. It is a question first of evidence — what facts can the plaintiff prove. Then it is a question of the meaning to be put on those facts — a question of construction, as lawyers call it. Latin synonyms are sometimes used for agreement, consensus or consensus ad idem.

In Raffles v. Wichelhaus (1846) 2 H & C 906, the defendants agreed to buy ‘125 bales of Surat cotton . . . to arrive ex Peerless from Bombay’. They refused to take delivery of goods which corresponded to that description. They said that the Peerless they meant was a ship which sailed from Bombay in October and the plaintiff was in breach of contract for not delivering from that ship, but attempting to deliver from another ship, also called Peerless, which left Bombay in December. The Court of Exchequer could not say which ship the contract meant and therefore had to give judgment for the defendants. The plaintiff could not show that the parties had ever been in agreement.

In Falck v. Williams [1900] AC 176, the plaintiff sued for breach of contract when the defendant refused to load the Semiramis with copra in Fiji. The defendant said that was not what the contract was about. He had agreed to load shale at Sydney! The cause of the confusion was the use of a telegraphic code. Everything depended on whether a word in the middle of the telegram was read with the words before it or after it. There was no punctuation to assist. The Privy Council could see no reason for preferring one interpretation to the other. They said, ‘It was the duty of the plaintiff to make out that the construction which he put upon it was the true one.’ He failed because the message was ambiguous. If the defendant had tried to enforce the contract as he understood it, he too would have failed for just the same reason.

3.2.2 Negotiation. If the processes of negotiation can be shown to have produced an agreement, that is sufficient, but sometimes it is necessary for the plaintiff to show where the contract was made, or more often when. The negotiations then have to be examined to discover at what point agreement occurred. This can usually be found by
looking for the moment when an offer was accepted. Moreover, there may be agreement on all the terms, and an intention to create legal relations, but the parties, or one of them, may not yet be willing to be bound, to enter into the contract. For a contract to come into existence, both parties must have exhibited a willingness to be bound, to create a legal obligation between them.

3.3 Offer

3.3.1 The nature of an offer. An agreement arises out of negotiation, whether that negotiation is simple or complex. If there is to be a contract, there must be evidence that the parties have manifested agreement. Usually one party proposes terms which the other, perhaps after much haggling, accepts. That proposal of a contract is called an offer.

An offer is a manifestation by one party (the offeror) to the other (the offeree) of a willingness to be bound to the offeree in contract, in the terms of the offer, if the offeree will show willingness to be bound to the offeror on the same terms. The offer gives to the offeree the power to create a contract by making an acceptance.

An offer may be made by spoken words or writing or conduct or any mixture of those methods. But all the stages in negotiation are not necessarily offers. They may not show any willingness to be bound to a contract immediately, without further negotiation.

3.3.2 Invitation to treat. A negotiating statement will not be an offer unless it shows that the offeror intends to give the offeree power to create a contract by accepting the offer without further negotiation. Whether such an intention exists is a question of fact to be proved by the evidence produced by the party seeking to rely on the contract. One kind of negotiating statement which lacks the intention is called an invitation to treat.

A person who advertises or displays goods for sale, for example, does not usually intend to give customers the power to make a contract by accepting without further negotiation. If you advertise your car for sale you do not intend that anyone who offers you the price can legally require you to sell it to him or her. A shopkeeper who puts goods in the window or a supermarket which puts goods out on the shelves does not usually intend to make an offer, or so the
courts have held. Such traders intend to invite customers to offer to buy and to keep to themselves the power to choose whether to accept that offer or not.

Most of the English cases have arisen from prosecutions for offences where it has been necessary to decide whether goods have been illegally offered for sale. In Partridge v. Crittenden [1968] 1 WLR 1204, the appellant had advertised for sale a bird which it was illegal to ‘offer for sale’. The Queen’s Bench Division held that the advertisement was not an offer. In Pharmaceutical Society v. Boots [1953] 1 QB 401, the English Court of Appeal held that goods on the shelves in a supermarket were not offered for sale. The cashier at the check out accepted the customer’s offer to buy, which was just as well for the chemists, because it was an offence to sell the goods unless a pharmacist was in attendance. The pharmacist supervised the check out but was not close enough to the shelves to supervise a sale if it had taken place there. There is no rule of law, however, that an advertisement or display cannot be an offer. The Court looks for the advertiser’s intention. In Harvela v. Royal Trust of Canada [1986] AC 207, the respondent advertised very valuable shares to the highest bidder. Harvela made the highest bid within the terms of the offer. The House of Lords held that there was then a contract. The advertisement was an offer. In Carlill v. Carbolic Smoke Ball Co. [1893] 1 QB 256, the defendants’ advertisement of a patent medicine was held to be an offer. They had made an unusual statement, however, that they had deposited a large sum with a bank to meet any claims, to show their seriousness. They had almost said the equivalent of: ‘This is an offer, not an invitation to treat.’

3.3.3 Auctions. The putting up of goods (or land) for sale by auction is not an offer. The person who bids makes an offer which the auctioneer may accept or reject. The Sale of Goods Ordinance (Cap 26) s60 provides that each higher bid destroys all earlier bids. The auctioneer’s final determination of the successful bid is the only acceptance.

3.3.4 Supply of information. A negotiating statement will not be an offer if it is merely intended to supply information, because then the intention to be bound will be lacking. The Privy Council, in an appeal from Jamaica, Harvey v. Facey [1893] AC 552, drew the distinction. The plaintiff sent a telegram to the defendants: ‘Will
you sell us Bumper Hall Pen? Telegraph lowest cash price.’ The defendant telegraphed: ‘Lowest cash price for Bumper Hall Pen £900.’ The plaintiff replied: ‘We agree to buy Bumper Hall Pen for the £900 asked by you.’ The defendant denied there was any contract. He had replied to the second question in the original telegram but not the first. He had not shown an intention to be bound. His reply was therefore not an offer. The plaintiff’s second telegram was an offer but the defendant had not accepted it. Merely to fix a price does not imply an offer to buy or sell.

3.3.5 The offeree. Only a person to whom the offer is addressed can accept it. The offer may be made to one person, or a number or class or the whole world. An offer made to A alone cannot be accepted by B. An offer made to A and B cannot be accepted by C. An offer to give a discount to all bona fide students cannot be accepted by someone who is not a student. An offer made to all the world is one which the offeror is happy to be accepted by anyone. The control of the offer is in the offeror’s hands. The advertisement in *Carlill v. Carbolic Smoke Ball Co.* [1893] 1 QB 256 offered £100 to anyone who used a medicine and still caught influenza. That offer was accepted whenever anyone used the smoke ball according to the directions.

3.4 Termination of Offer

3.4.1 Termination by acceptance. An offer to one person will come to an end if it is accepted — its purpose is then fulfilled — or if it is rejected or if for some reason it lapses. Of course an offer to more than one person may not come to an end on acceptance or rejection by one offeree. That depends on the terms of the offer. If I offer my car for sale to two offerees, and it is clear I have only one car, then the first acceptance will make a contract. If the other offeree also does all that is necessary to accept, that may also make a contract. There is only one car. The offeree who first accepts will usually be able to claim the car. The offeree who made the second acceptance will not get the car but may have a claim for damages against the offeror for breach of contract. The offeror could have avoided that claim by making it clear that the offer was conditional on the car not having already been sold. If the offeror is a car dealer and offers not
one specific car but cars of a stated description, then it is clear the offeror is willing to make any number of contracts.

3.4.2 **Termination by rejection.** If the offeree rejects the offer, that is an end of it. Rejection may be express: ‘No, I will not buy at that price.’ Or it may be implied, as it is if the offeree makes a counter-offer: ‘Not $10,000 a ton but $9,000.’ An offeree cannot claim that an offer is still open once it has been rejected by that offeree, whether the rejection is express or implied from a counter-offer. Not all statements or questions made during negotiations carry an intention to accept or reject. If you offer to sell me shirts at $750 a dozen and I reply offering $650, that is a rejection of your offer. You can accept my offer of $650. If you refuse, there is no offer remaining at $750 which I can go back to and accept. But if, after receiving your offer at $750, I had asked you what your credit terms were, or even whether you allowed a discount for orders over a certain amount, my questions could not be construed as rejections. They were not counter offers but merely requests for information to clarify the terms of your offer. The distinction was well drawn in *Stevenson v. McLean* (1880) 5 QBD 346. A offered by letter to sell iron to B for 40 shillings a ton. B replied by telegram asking, ‘Please wire whether you would accept 40 for delivery over two months or, if not, longest limit you would give.’ B was not asking for credit. B would still pay cash on delivery but preferred to take delivery by instalments. B’s telegram was not a counter-offer. No implied rejection of A’s offer could be inferred. A’s offer stayed open. When B, without waiting for a reply, sent A an acceptance, there was a contract.

3.4.3 **Termination by revocation.** The offeror is in control of the offer. Nothing binds the offeror until acceptance makes a contract. The offeror can withdraw the offer until that time. Problems of timing arise when the parties are not face to face. Once merchants started to use the post to communicate with one another, with a necessary time lag between sending and receiving communications during the negotiation of a contract, then it became necessary to decide whether an offer had been revoked before it was accepted.

The general rule is, not surprisingly, that a communication of whatever kind takes effect when it is communicated. An offer is only effective when it comes to the offeree’s notice. If the buyer had bought the smoke ball and used it, and only later had seen the notice,
then the notice could not have been an offer or any part of a contract between Carlill and the Carbolic Smoke Ball Co. and that case would have been decided the other way. Similarly, a revocation is only effective when it is communicated.

3.4.4 **Options.** It is possible to pay the offeror to keep the offer open for a stated period. That is called taking an option. An option is a separate contract between offeror and offeree. A mere promise by the offeror to keep the offer open does not bind the offeror. As we shall see (3.7), a promise is binding only if supported by consideration, that is it has been paid for, or is made by deed.

3.4.5 **Authority to revoke.** Unauthorized statements by strangers should not affect negotiations between the parties. In *Dickinson v. Dodds* (1876) 2 Ch D 463, the English Court of Appeal held that, where an offeree heard from a stranger that the offeror had sold the offered property to someone else, the offeree could not accept. Somehow the offer had been revoked. That decision is not in line with a modern Privy Council decision, *British Guiana Credit Corporation v. Da Silva* [1965] 1 WLR 248 (3.5.3), and is not likely to be followed in Hong Kong.

3.4.6 **Lapse.** If the offer is neither accepted nor rejected, and the offeror does not revoke it, it will continue in existence until it lapses. If the offeror stated a period for the offer to stay open, it lapses when that time expires. If no period is fixed, the offer lapses after a reasonable time. What is reasonable depends on the sort of deal the parties are contemplating and all the surrounding circumstances.

If the offeror dies, the offer will lapse only if the contract would need the offeror’s personal performance. If it is to play professional football, those who succeed to his property cannot perform it. If it is to sell a flat, they can.

If the offeree dies, then whether the offer lapses should similarly depend on whether it was made to the offeree personally or can be impliedly extended to those who succeed to the offeree’s property on death.

There are no cases decided on lapse on death which provide rules for Hong Kong. Justice and convenience require the rules suggested here.
3.5 **Acceptance**

3.5.1 *The nature of acceptance.* Acceptance is the manifestation, by an offeree, of willingness to be bound to the offeror by a contract on the terms of the offer. Like any other stage in the negotiations, it may be by spoken or written words, or by conduct, or any combination of those methods. Once acceptance is made, the contract comes into existence and its terms are fixed at that moment.

3.5.2 *Method of acceptance.* The general rule (3.4.3) is that a negotiating communication is effective when it is communicated. Like an offer, a revocation, a counter-offer or other rejection, an acceptance takes effect when it is communicated. If a communication is by letter or telegram, the party trying to prove communication does not usually have to show that the recipient has actually read it, even less has understood it. It is enough that it has been delivered; otherwise business deals would be uncertain, and nobody would know whether their acceptance had worked or not to make a contract.

What if the offeror had said: ‘To signify acceptance, all you have to do is post a letter. It makes no difference when it arrives. We will both be bound by the contract from the moment you post it’? Offerors are in control of their offers and can make their offers in any way they like. They can demand acceptance just as they choose. They can insist that the offeree accepts face to face, or by telephone or cable or telex or fax or sky writing if they like. When the courts first had to deal with negotiations by post, they held that where the offeror had not stipulated any method of acceptance but had sent the offer by post, then the offeree could accept by post. But the courts went a stage further. They held that in those circumstances acceptance would take effect not when the letter was delivered but when it was posted. This exception to the general rule that communications are effective when received can now be stated thus: if it is reasonable to assume that the offeror was prepared to receive acceptance by post, then acceptance is complete when the letter containing it is posted, not when it is received. Even if the letter never arrives, there is a contract from the moment of posting. The justification for this exception is that offerors can always exclude it if they care enough.

If the acceptance is by telegram, and the offeror can be assumed to approve that means of communication, then in England acceptance is complete when the message is received by the Post Office.
not when delivered to the offeror. In Hong Kong, telegraphic communication is in the hands of a commercial organization, Cable and Wireless, which presumably takes the place of the Post Office. Presumably, also, commercial couriers would be treated like the Post Office in respect of letters. How the exception works can be seen from the facts of *Byrne v. Van Tienhoven* (1880) 5 CPD 344:

1 October  Defendants post OFFER to plaintiffs.
8 October  Defendants post REVOCATION to plaintiffs.
11 October  Plaintiffs receive OFFER and send ACCEPTANCE by telegram.
15 October  Plaintiffs send letter confirming ACCEPTANCE.
20 October  Plaintiffs receive REVOCATION.

The Common Pleas Division in England held that a contract was made by an effective acceptance on 11 October, ‘upon the principle that the writer of the offer has expressly or impliedly assented to treat an answer to him by a letter duly posted as a sufficient acceptance and notification to himself’.

If the acceptance is not by telegram or letter but by some electronic means which is nearly instantaneous, such as telephone or telex, then the ‘postal rule’ will not apply. There is no need to make an exception to the general rule that communication is required. The House of Lords held in *Brinkibon v. Stahag Stahl* [1983] 2 AC 34 that a telexed acceptance is effective when and therefore where it is received, unless the parties could be held to have intended otherwise. The same applies to fax messages, though it is a facsimile that the offeror receives from the machine, not the original document: *Susanto-Wing Sun v. Yung Chi* (1988) No A8177.

3.5.3 **Authority to accept.** In 3.4.5 it was shown that there are authorities that suggest that an unauthorized revocation can be effective. That is unlikely to be the law in Hong Kong and there is no doubt that acceptance must be authorized. In *British Guiana Credit Corporation v. Da Silva* [1965] 1 WLR 248, Da Silva applied to BGCC for a job. BGCC’s selection committee instructed BGCC’s secretary to write to Da Silva to tell him he was the successful candidate. The same afternoon, 22 September, the chairman of the selection committee told Da Silva that he had got the job. The secretary on 26
September handed the letter of appointment to Da Silva. The Privy Council held that the contract of employment was created on 26 September, not by the unauthorized communication of 22 September.

3.5.4 *Acceptance by conduct without communication.* A contract cannot be forced on the offeree. There is no contract if you are sent an offer through the post which says ‘we shall assume you accept our offer of this prestigious set of encyclopedias unless you reply to the contrary within 14 days.’ You can ignore such an offer. If I offer a reward for my lost dog and you find it, you do not have to communicate acceptance. I will not be allowed to withdraw my offer when I see you approaching with the dog. Your act is sufficient acceptance. Why? Because that can be read into the offer. It is implied in the advertisement.

More interesting for a student of business, though, is the problem resolved in *Brogden v. Metropolitan Railway* (1877) 2 App Cas 666. Brogden had supplied the railway company with coal for many years. There had never been any contract between them, except the individual contracts for the sale of each consignment. They decided to put their transactions into a formal contract, which would have a clause submitting disputes to arbitration. The railway sent Brogden a draft agreement with a space left for the name of the arbitrator. Brogden put in the name of the arbitrator he wanted and sent the draft back, marked ‘approved’. The railway’s agent put the draft in a drawer and forgot about it. Thereafter both parties behaved as before, ordering, supplying and paying for coal as it was needed, but acting on the terms of the draft agreement, as if it were a contract which bound them. Then a dispute arose and Brogden denied there was a contract. Sending the draft to him was an offer but he had not merely declared his acceptance. He had added the name of the arbitrator and sent it back. That was a counter-offer, which must have lapsed by the time of the dispute, if it had not been accepted within a reasonable time. The House of Lords held that a contract had come into existence when the parties had shown by their acts that they were acting in accordance with its terms: if not when the railway ordered its first lot of coal, then certainly when Brogden supplied it.

A strict application of the rule that the acceptance must not introduce new terms would stop many deals becoming contracts,
greatly to the surprise of the parties. An everyday example arises where a wholesaler is buying goods from the manufacturer. The wholesaler orders the goods on an ‘order form’. That looks like an offer to buy and both parties believe it is. Often, on the back of the order form, are all sorts of terms intended to give legal advantages to the wholesaler. The manufacturer, if the offer is attractive, sends a ‘sales note’ or ‘invoice’ which both parties believe is an acceptance and makes a binding contract. But the sales note also has terms on the back, intended to increase the manufacturer’s legal advantages and clashing with those on the wholesaler’s order form. The parties clearly intended that there should be a contract. The court will usually decide there is a contract if, as in Brogden’s case, the parties have acted as if there was. But on whose terms? The problem, one of construction, is dealt with in 4.11.

3.5.5 *Contract without offer and acceptance.* Even if it can be definitely shown that there could not have been an offer by one party accepted by the other, there can still be a contract. Suppose you have agreed to sell me your car and we have fixed all the terms but the price, with you insisting on $120,000 and me determined to pay no more than $110,000. A friend of ours sees us haggling and says ‘Why don’t you settle for $115,000 and then we can all go for a game of snooker?’ You and I nod at one another and shake hands. Is there a contract? Of course there is. We have both manifested agreement to the same contract. But where is the offer and acceptance? In *Clarke v. Dunraven* [1897] AC 59 the House of Lords found there was a contract between two entrants in a boat race because both had signed an undertaking to be bound to other entrants by the rules, though neither had addressed any contractual message to the other.

3.5.6 *Express postponement of agreement.* It takes two to agree. If one party says ‘I am happy with the terms but I do not want to be bound yet’, that will postpone the creation of the contract until the satisfaction of whatever prerequisite has been stated. A simple example is a provision in a printed hire-purchase form which says: ‘This agreement shall become binding on the owner only upon acceptance by signature on behalf of the owner’. In *Financings v. Stimson* [1962] 3 All ER 386, the English Court of Appeal held that that clause prevented any contract coming into effect until Financings signed it. In negotiations relating to land it is common for there to be a period
between agreement of all the terms and the creation of a binding contract. During that time the buyer’s solicitor can make enquiries about such matters as planning restrictions. It is common for the parties at that stage to sign an agreement stated to be ‘subject to contract’. If those exact words are used, the courts will usually find a clear intention not to make a contract at that stage, though even then the court will follow the expressed intention of the parties. In *Hong Kong Housing v. Hung Pui* (1986) HCA 403, the court found that the technical phrase ‘subject to contract’ had been put in by mistake, and that the conduct of both parties showed they did not intend it to be there. Phrases which sound similar may not have the same effect. ‘A provisional agreement’ may mean a contract which, though immediately binding, is intended to be replaced later, perhaps by a more formal one. The problem can be complicated by the need to translate or to compare two versions in English and Chinese. In *Lam Wa-leung v. So Chung-shek* [1982] HKLR 3818 the agreement was written in Chinese. The heading was (in Chinese characters) ‘Lum-see Hip-yee’. There was no argument about ‘hip-yee’. That means ‘agreement’. But what does ‘lum-see’ mean? It is translated both as ‘temporary’ and ‘provisional’. But not ‘conditional’, because its literal meaning is ‘short time’. The court held that there was a contract. The parties had used words showing that their contract was to be temporary. They had shown no intention to postpone its legally binding force.

### 3.6 Tenders

A person who intends to buy goods or services may advertise asking suppliers to tender for a contract. By this method the buyer can find out the lowest price at which goods of the required specification can be bought. Potential suppliers make offers when they reply to the advertisement. If the tender is for specified goods or services at a fixed price, that is if the terms of the offer are clear and need no further negotiation, there is a contract when the buyer signifies acceptance of the tender. But sometimes, although the buyer’s needs are not able to be fixed, the price and availability must be. So the buyer advertises for tenders to supply whatever goods of the agreed specification the buyer shall order from time to time. What the buyer wants is a standing offer. The tenderer is keen to get the business
and hopes to do so by manifesting a continuing willingness to supply goods of the tender specification at the tender price. No contract arises when the buyer ‘accepts’ the tender. That is merely an indication that the buyer intends to buy from the tenderer on the agreed terms. A contract arises when the buyer places orders with the tenderer. Each order is an acceptance of the standing offer. There is no contract to make the buyer place any orders or to stop the buyer buying the specified goods from another supplier. The tenderer can withdraw the offer at any time, though any orders placed before that date have created binding contracts. If, however, the tender is to supply all the goods of a specified kind that the buyer shall need for a fixed period, then a contract is made when the tender is accepted. The buyer has no obligation to buy any goods but breaks the contract by buying goods from anyone other than the successful tenderer. In *Yeu Shing v. Pioneer Concrete* (1987) HCA No. 36, Pioneer contracted to supply Yeu Shing with concrete on the terms of a ‘quotation acceptance’. A quotation, like a tender, is usually construed as an offer. Yeu Shing had accepted the quotation and thereby bound itself not to buy from anyone else but Pioneer. Pioneer had bound itself to supply Yeu Shing’s needs for concrete, up to the stated limit for the stated period. Yeu Shing could not refuse to accept Pioneer’s orders within those limits.

### 3.7 Consideration

#### 3.7.1 The nature of consideration.

In 2.2 the basis of the common law of contract was shown to be bargain. Those who want a Hong Kong court to enforce a contract must show they have paid a price for the broken promise. Lawyers call that price consideration.

The general idea is easy to understand, but its application in practice is often difficult. The need to prove consideration sometimes forces the courts to refuse to enforce a promise seriously made which the promisee has relied on and acted on to its detriment. Few judges enjoy deciding cases against the merits and strenuous attempts have been made to extend any available exception to the requirement of consideration. The extension of exceptions by ingenious judges seeking to do justice in the action before them is a vital force in the adaptation of the law to meet society’s needs but it does not make for straightforward rules. Yesterday’s areas of discretion
become well established and well defined principles tomorrow but a beginner cannot be expected to be a prophet. The principles explained here are as dependable as the authors can make them. Controversies among legal scholars can have no place in this book.

3.7.2 Sufficient consideration. Consideration is the price of the promise which the promisee is seeking to enforce, and the law generally leaves it to the parties to decide whether the price is a fair one. Although the law will not accept some kinds of consideration, it will not reject the consideration because it is a poor price for what it buys. It is the parties’ job to make their own bargain. This makes it possible to make a gratuitous promise binding by giving in exchange a nominal consideration such as the traditional peppercorn. If the parties have agreed that a nominal consideration shall be the price of the promise, the courts will not usually refuse to enforce the contract on the ground that the consideration is inadequate, though they may take this into account in deciding whether there has been fraud or other unconscionable conduct.

3.7.3 Past consideration. Past consideration is insufficient because it is not consideration at all. ‘Past consideration’ is the term used to describe an act which would have been sufficient for the promise it is said to support, if it had been the price of that promise, but it was not.

Consideration has traditionally been divided into three categories: executory, executed, and past. If A makes a promise to B in consideration of B making a promise to A, both parties have duties still to perform under the contract. The contract is said to be executory, and the consideration given by both parties is said to be executory. In this context executory means ‘to be performed in the future’. If A offers a reward for the return of a lost dog, and B returns it, the consideration for B’s act is A’s promise, which is still executory, but the consideration for A’s promise is not a promise by B, who has never made any promise to A, but B’s act, which has already been performed. The contract is sometimes said to be executed, and B’s consideration is said to be executed. Consideration is sufficient whether it is executory or executed. It is in both cases the price of the promise. But if A sells a car to B and after the sale is over A promises B that none of the tyres is a retread, and this is untrue, B cannot sue A on the promise. The new promise was not
part of the bargain when the contract of sale was made. It will not bind A unless B gave some new consideration for it. B had already given or promised A the price of the car, and did nothing extra to buy A’s new promise.

If at the time when an act is done by A for B, it is understood between them that B will pay for it, but no price is fixed, then B will be bound to pay a reasonable price, on the basis of what the law calls quantum meruit, which means ‘as much as he has earned’. If B then agrees with A to pay A $500 for the job, there is sufficient consideration. B’s promise has merely quantified the obligation. In Pao On v. Lau Yiu-long [1980] AC 614, where a contractual promise was said to have been given for a past consideration, the Privy Council laid down the principle again:

An act done before the giving of a promise to make a payment or to confer some other benefit can sometimes be consideration for the promise. The act must have been done at the promisor’s request, the parties must have understood that the act was to be remunerated further by a payment or the conferment of some other benefit, and payment, or the conferment of a benefit, must have been legally enforceable had it been promised in advance.

An exception to the rule that past consideration is no consideration is in Bills of Exchange Ordinance (Cap 19) s27(1)(b) which provides that a cheque or other bill of exchange is sufficiently supported by consideration to make a holder a ‘holder for value’ even if the consideration is an ‘antecedent debt or liability’; Cheques 5.2.2.

3.7.4 Valueless consideration. It has already been said that the courts leave it to the parties to fix the price. This is the general rule, but there are exceptions. It is no consideration that the promise was given from a feeling of moral duty or from ‘natural love and affection’. It is clear that such motives, however worthy they may be, are not the price for the promise. Yet it may be clear that the motive for the promise was moral obligation and the court will still enforce the promise if it can find some benefit to the promisor or detriment to the promisee to support the promise, even though it is clear that it was not intended by the parties to be the price of the promise. In
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Thomas v. Thomas (1842) 114 ER 330, A told his executors before he died that he wanted his wife to have the house in which they lived and its contents or £100 instead. ‘In consideration of such desire’ the executors agreed to convey the house to A’s widow for life, subject to her agreeing to pay £1 a year towards the ground rent on this and other property in A’s estate. The Court held that while the wish to fulfil the testator’s desires was not sufficient consideration for the agreement to convey the house, the promise of the widow to pay £1 a year ground rent, while not intended by the parties to be the price of the promise, was good consideration.

Note the fine distinction between Thomas v. Thomas and Re McArdle [1951] Ch 669, where a house was left by McArdle to his widow for her lifetime and then to their children jointly. While Mrs McArdle was still alive, one son and his wife lived with her. That daughter-in-law paid for improvements. When Mrs McArdle died and the house passed to all the children jointly, those improvements had increased its value. All the children signed an agreement to reimburse the daughter-in-law, saying ‘in consideration of your carrying out certain alterations’ they undertook to pay her £488. The English Court of Appeal held that the consideration for that promise was past and could not support a contract. There are over a hundred years between the two cases, so you cannot assume that modern courts are always more eager to find ways of finding according to the merits than their predecessors were.

3.7.5 Forbearance to sue. An example of a consideration which is real but impossible to quantify arises where one person promises not to sue another in return for the other’s promise to pay a sum of money. If Lee promises to pay Ho $10,000 if Ho will drop an action against Lee, Lee’s promise is given for good consideration and Ho can sue on it. Even if it becomes clear that Ho’s claim would not have succeeded, Ho can still recover the $10,000 unless the action was frivolous, or it can be shown that Ho had no honest belief in the chances of success, or concealed from Lee something which would have enabled Lee to defend the action successfully.

3.7.6 Promises to do something already owed.

3.7.6.1 A promise to perform what is already owed to a third party. If Chang owes Wong $10,000, Wu may for some reason want Chang
to pay up. Perhaps Wong will then be able to repay money owed to Wu. Wu may promise Chang $1,000 if Chang pays Wong the $10,000. If Chang does pay Wong and has to sue Wu for the $1,000, Wu cannot plead that Chang gave Wu no consideration for the promise to pay $1,000. A promise to perform an obligation owed to a third party can be good consideration.

Indeed, it is strange that the question should ever have been asked, for it is clear that mutual promises are good consideration the one for the other, and it cannot be denied that in our example, where A owes B $100 and C promises A $10 if A will pay the debt to B, then if C pays A the $10, C can sue A if A does not pay B. Surely A will not be allowed to plead that A need not carry out the promise to C because A had already made the same promise to B. That would provide an escape for everyone who wished to get out of a contract.

3.7.6.2 A promise to perform an existing public duty. There is no reason why a promise to perform an existing public duty should not be good consideration for a promise to pay for that performance by a private individual who is interested in having the duty performed. Lord Denning, an outstanding reformer of the common law, has held that a promise to perform a public duty is in any case good consideration, so long as it is not against public policy. The other judges have, however, shown some reluctance to accept this just principle, and have based their decisions on their ability to discover some other consideration for the promise than the mere promise to perform the public duty, but they have had to work hard to find it in some cases. In Ward v. Byham [1956] 2 All ER 318, A and B lived as man and wife, though they were not married, from 1949 to 1954. They had a child in 1950. In 1954, A turned B out but kept the child. Some months later B wrote to A asking if he would let her have the child. A replied that he would let B have the child and pay £1 a week towards its upkeep if B would prove that the child was well looked after and happy and would allow the child to decide, when she was old enough, whether she wanted to live with A or B. B took the child and A paid £1 a week until B married another man. Then A stopped paying and B sued him on the promise contained in his letter. A pleaded that there was no consideration for his promise as B was already bound to keep the child, as the mother of an illegitimate child was bound by statute to support it. The English Court of Appeal found that there was a promise to do something more than
was required by statute and therefore avoided the issue, but Lord Denning faced the problem and answered as stated above. The problem is not a pressing one, as the judges will seek to do justice either directly or by some time-honoured judicial subterfuge.

Clearly if it is against public policy to allow a person to bargain for the performance of a public duty, the courts should not enforce the bargain, but that is quite another thing than insufficiency of consideration. If, when you are being attacked by a thief, a passing policeman offers his services at a price, you will not be bound by a promise to pay him, not because your promise was not supported by sufficient consideration but because to enforce it would be against public policy.

**3.7.6.3 A promise to perform a duty already owed by contract to the same promisee.** If B already has a contractual right to make A do something, and B promises A something more if A will perform or repeat the promise, then there is no doubt that the price for B’s further promise is A’s promise or performance of an act A was already bound to B to perform. B may well have had good reason to believe that A would not perform unless B made the further promise, and B may have thought that this was a good enough price for the promise. But the law would not previously admit the sufficiency of such consideration. Until recently the law was found in two old cases with similar facts. In both, sailors were promised extra pay if they would work the ship shorthanded. When they had done so, the shipowners refused to pay them the extra. In *Hartley v. Ponsonby* (1809) 119 ER 1471 the sailors succeeded in their claim for the extra wages. The court held that the shorthandedness was so drastic that they were asked to perform something quite different from what their contract demanded. But in *Stilk v. Myrick* (1809) 170 ER 1168 it was held that the sailors were not entitled to the extra wages because they had done no more than they were bound by contract to do. If you or we were asked to cover for a sick colleague temporarily it would mean extra work but we would usually feel it came within our duties to do it — though only up to a point and we would expect the law to assist us if we were promised a bonus or overtime and then refused payment.

The English Court of Appeal in *Williams v. Roffey* [1980] 1 All ER 312 considered that it was no longer necessary to be so technical about consideration. It was a building case. The sub-contractors
asked the main contractors for more money than the contract entitled them to. Otherwise, they said, they could not complete on time. It seems they had run into genuine difficulties. Courts in the past have not found such difficulties to be relevant unless they amounted to frustration; 6.6. Contracting parties must perform what they have promised in return for what they have been promised. But the main contractor faced a penalty if the work was not finished on time. So it agreed to make extra payments. But then it refused to pay. The court held that the key to consideration was to be found in the fact that the main contractor was worried about the penalty and it was a benefit to it to have the sub-contract performed on time. However, the court took care to point out that, if the sub-contractor had brought any unfair pressure on the main contractor, the main contractor would have been protected by the doctrine of economic duress; 5.6.2, which did not exist at the time of the 1809 cases.

A promise to forgo contractual rights in return for partial performance of the contract, or a promise of partial performance. One of the most exciting developments in the law of contract since the Second World War has been Lord Denning’s struggle to establish the doctrine of promissory estoppel. It arose in this way. There is no doubt that consideration is necessary for the formation of a simple contract. ‘Simple’ in this context means ‘not made by deed’. It need not follow that there must be consideration for a promise to forgo contractual rights, even less for an immediate waiver or surrender of contractual rights. Yet the law has extended the requirement of consideration to these situations. This gave rise to the rule, sometimes known as the rule in *Pinnel’s Case* (1602) 5 Co Rep 117a, which was elaborated in *Foakes v. Beer* (1884) 9 App Cas 605 and may be stated as follows:

Payment of a smaller sum than that owed under the contract is no consideration for a promise by the creditor to release the contractual debt.

If A owes B $100 and B agrees to accept $50 in discharge of the debt, B may according to this rule take the $50, promise not to ask for more, then sue for the balance despite that promise. So far, then, had an outworn economic philosophy taken the judges from the commonly accepted standards of business people. In *Foakes v.*
Beer A owed B a debt and B got a judgment against him. They agreed that A should pay off the judgment debt by a stated down payment and instalments. Nothing was said about interest. B accepted these payments and, when she had all the money she had been promised, sued for interest at the rate normal for judgment debts. The House of Lords held that B could recover the interest in spite of her implied promise not to demand it, which was not binding because there was no consideration to support it. Various tricks were employed by judges to avoid this unfortunate decision and its predecessors. It was held that a payment of part was sufficient if by cheque, though no one ever explained how that could be more advantageous than the same amount in cash, and this has since been overruled. Any other difference in performance, such as payment before the due date or even at a different place was held sufficient. Certainly if instead of the $100 B accepts a packet of cigarettes, the court will not enquire into the adequacy of the substituted consideration. Moreover, if the smaller sum was paid or promised by a third party C, the court would not allow B to sue A for the balance, for it was said that would be a fraud on C.

The problem does not arise only where a creditor agrees to forgo part of a debt. It may be that the performance in question is not the payment of a sum of money but some other service by the ‘debtor’. Lord Denning made for himself the opportunity of dealing with the problem in the High Trees case: Central London Property v. High Trees House [1947] KB 130. A modified and improved version of the High Trees doctrine has been accepted and restated by the Privy Council in Ajayi v. Briscoe [1964] 1 WLR 1326:

The principle, which has been described as quasi estoppel and perhaps more aptly as promissory estoppel, is that, when one party to a contract in the absence of fresh consideration agrees not to enforce his rights, an equity will be raised in favour of the other party. This equity is, however, subject to the qualifications:

1. that the other party has altered his position,
2. that the promisor can resile from his promise on giving reasonable notice, which need not be formal notice, giving the promisee a reasonable opportunity of resuming his position,
3. the promise only becomes final and irrevocable if the promisee cannot resume his position.

Note that the doctrine gives equitable rights. Parties who wish to rely on it must show they have themselves behaved equitably. In *D and C Builders v. Rees* [1966] 2 QB 617, D and C, jobbing builders, did work for A, a builders’ merchant, and rendered accounts for £746. A paid £250 and was allowed £14 off the bill. Then, in spite of demands for the £482 balance, A did not pay any more. He set his wife on to D and C. She spoke to C on the telephone. She made complaints about the work and said, ‘My husband will offer you £300 in settlement. That is all you’ll get. It is to be in satisfaction’. D and C knew that without the £300 their firm would be insolvent. They accepted the £300 under protest. A’s wife insisted that the receipt should state that the sum was received ‘in completion of the account’. Here was a case where unfair pressure had been put on the creditor. Lord Denning was not prepared to see the equity arising from promissory estoppel used in this way:

This case is of some consequence: for it is a daily occurrence that a merchant or tradesman, who is owed a sum of money, is asked to take less. The debtor says he is in difficulties. He offers a lesser sum in settlement, cash down. He says he cannot pay more. The creditor is considerate. He accepts the proffered sum and forgives him the rest of the debt. The question arises: Is the settlement binding on the creditor? The answer is that, in point of law, the creditor is not bound by the settlement. He can the next day sue the debtor for the balance, and get judgment. The law was so stated in 1602 by Lord Coke in *Pinnel’s Case* — and accepted . . . by the House of Lords in *Foakes v. Beer* . . . But a remedy has been found. The harshness of the common law has been relieved. Equity has stretched a more merciful hand to help the debtor.

This principle has been applied to cases where a creditor agrees to accept a lesser sum in discharge of a greater. So much so that we can now say that, when a creditor and a debtor enter upon a course of negotiation, which leads the debtor to suppose that, on payment of the lesser sum, the creditor will not enforce payment of the balance, and on
the faith thereof the debtor pays the lesser sum and the creditor accepts it as satisfaction; then the creditor will not be allowed to enforce payment of the balance when it would be inequitable to do so.

In applying this principle, however, we must note the qualification: the creditor is only barred from his legal rights when it would be inequitable for him to insist upon them. Where there has been a true accord, under which the creditor voluntarily agrees to accept a lesser sum in satisfaction, and the debtor acts upon that accord by paying the lesser sum and the creditor accepts it, then it is inequitable for the creditor afterwards to insist on the balance. But he is not bound unless there has been truly an accord between them.

In the present case, on the facts found by the judge, it seems to me that there was no true accord. The debtor’s wife held the creditor to ransom.

In my opinion there is no reason in law or equity why the creditor should not enforce the full amount of the debt due to him.

Some problems remain in applying the principles set out in Ajayi v. Briscoe. First, no one has yet sorted out what ‘has altered his position’ means. The interpretation put upon this phrase by the judges in future cases will determine the scope of promissory estoppel. Secondly, it is important to remember that promissory estoppel is relevant only where the parties are already bound to one another by contract. It never takes the place of consideration in the creation of a contract, only in modifying or discharging it.

**Points to Note**

1. A plaintiff seeking to bring an action on a contract carries the burden of proving to the Court that a contract exists and what its terms are.

2. The plaintiff must show that the parties intended to create legal relations.
3. Commercial agreements are presumed to be intended to be contracts.

4. Family and social agreements are presumed to be intended not to be contracts.

5. Whether the parties have agreed is first a question of fact — of evidence — then of law — of construction — that is interpretation of the meaning of the facts.

6. A contract is created only when both parties have shown a willingness to be bound by contract on terms agreed between them.

7. Agreement is usually proved by showing acceptance of an offer.

8. The proposal of a contract is called an offer, which is the offeror’s manifestation of willingness to be bound to the offeree in contract, in the terms of the offer. An offer gives the offeree power to make a contract by accepting those terms.

9. An offer may be in writing, by spoken words, by conduct, or by any mixture of those methods.

10. An invitation to treat differs from an offer because it does not give the offeree power to create a contract. It is an invitation to make offers. Similarly, the supply of information is not an offer. Whether a stage in negotiations is an offer or not depends on the intention of the person initiating it.

11. An offer may be made to one or more individuals, a class, or the whole world.

12. An offer may be terminated by acceptance, rejection, counter-offer, revocation, or lapse.

13. An offer may be withdrawn at any time before acceptance, unless it is an option.

14. Acceptance is the manifestation by an offeree of willingness to be bound by a contract in the terms of the offer.
15. Acceptance may be by written or spoken words, or by conduct, or by any mixture of those methods.

16. The offeror may stipulate the method of acceptance.

17. Upon acceptance of the offer, the contract comes into existence on the agreed terms.

18. Acceptance is effective when communicated or signified in the way stipulated, expressly or impliedly, by the offeror.

19. If the offeror has signified a willingness to take acceptance by letter or telegram, acceptance will be effective when the letter is posted or the telegram despatched.

20. Telexes, fax messages and telephoned acceptances take effect according to the general rule, i.e., when communicated.

21. Communication of acceptance is valid only if authorized.

22. Agreement may be evidenced without offer and acceptance.

23. The parties may agree all the terms but postpone the making of the contract. The words ‘subject to contract’ will usually, but not necessarily, have that effect.

24. The basis of the common law of contract is bargain.

25. Those who want the court to enforce a promise must show they have paid a price for it.

26. A promise unsupported by consideration cannot make a contract. It is not binding unless incorporated in a deed.

27. Past consideration is no consideration.

28. Consideration may be executed or executory.

29. Executory consideration is a return promise.
30. Executed consideration is an act for which the promise was given.

31. If the consideration is a promise to pay an unfixed sum, a later promise to pay a fixed amount is supported by consideration.

32. Forbearance to sue is sufficient consideration unless the one who forbears conceals something relevant from the other party.

33. A promise to perform an obligation already owed to a third party is good consideration.

34. A promise to perform a public duty is good consideration unless it would be against public policy to enforce it.

35. A promise to perform a duty already owed in contract to the same promisee may be good consideration provided there is no unfair pressure amounting to economic duress.

36. A promise to forgo contractual rights in return for partial performance of the contract (or for a promise of that partial performance) is not good consideration. Payment by the debtor of a smaller sum than that owed under the contract is no consideration for a promise by the creditor to release the debtor. But the creditor may be estopped in equity from suing for the balance, by promissory estoppel.
Chapter 4

How Contracts Are Interpreted

4.1 Seeking the Meaning

Once we have reached the stage of being certain that a binding agreement — a contract — exists, we must then look to see what is within the contract.

Does this sound to be the wrong way round? Surely, the agreement decides what is within the contract? It is true that the major strands of agreement will be clear at the time the contract is made; the consideration usually provides the most important promises on both sides. But things do not always go smoothly, and when unexpected events arise later, it is necessary to see what the contract says about them, expressly or even by implication. The parties to a contract may not have a clear idea of every part of their contract, especially where one party has accepted the other’s standard form.

Also, contracts vary in their complexity, some covering many typed pages, and others consisting of a short telephone call. As well as the clear and outward expressions of agreement, there may be unspoken terms too, known as implied terms. So it is not surprising that the parties may have only an outline idea of what is really in their contract.

4.2 Statements

First of all, we must do a sifting exercise to see what, of all the things said and written, amount to terms of a contract. Terms are contractually binding promises. Not all statements made during negotiations are terms, but unfortunately it is often far from clear at first glance which statements are terms and which are not. There is a spectrum, or a sliding scale, rather than a series of easily recognized categories.

Nevertheless, a statement has to be categorized if we are to
know how to deal with a situation where the statement has turned out to be false or misleading. There are three basic categories, puff, representation and term. However, a statement may be classed as none of these, but as a condition precedent or subsequent, or as part of a collateral contract. We will concentrate first on the situation arising when the statement has reference to the main contract — that is, as puff, representation or term.

4.3  Puff or Representation?

No one seriously expects a seller of goods or services to say: ‘Here is what I have to offer. It is really bad and inferior to others of the same kind on the market. I really would not buy it if I were you.’ Not even if this is the absolute truth. We have to allow for what is known as ‘trader’s puff’. The amount of poetic licence allowed to traders tends to vary over the years, and probably a nineteenth-century trader could have got away with more than a twentieth-century trader would. The courts tend to look at the circumstances in which the statement was made, and to whom it was made. Remarks by car salesmen, for example, tend to be treated relatively severely.

One rule of thumb is that when the remark concerns facts which can be checked, it is more likely to be a representation. So if a car salesman says ‘this car has only had one owner’, this cannot possibly be a mere puff, for a statement of fact is being made. If he says ‘this is a delightful little car’, that sounds more like a puff.

4.4  Representation or Term?

A representation, we can see, contains a statement which can be checked. How does it differ from a term of the contract? One way to answer this is to say that the remedies vary. Remedies are dealt with at length in Chapter 7. There is no remedy at all for a false puff. The remedies for false representations are quite different from the remedies for breaches of terms.

A term contains a promise which is an integral part of the contract, and that is why a broken contractual promise amounts to breach of contract. A representation is a statement made to lure a person on into making a contract. It is not part of the contract,
although it may contain a promise. The test as to whether the
statement is merely a lure or is part of the contract is simply a test of
the parties’ intentions. That is, you ask which the parties intended
the statement to be, using all the evidence you can find from an
examination of the circumstances in which the contract was made.

This kind of test is simple to describe, but difficult to apply.
Therefore the courts have developed guidelines over the years, in an
attempt to shorten the process of deciding the intentions of the
parties. It must be understood that the guidelines are not rules, and
that they may conflict among themselves or may be abandoned by a
judge as not appropriate. Individual circumstances are the most
important factors, and the following guidelines are only rough guides.

4.4.1 Time. Was the statement made at the beginning of long negotia-
tions, to attract the customer’s attention? And was it never repeated?
If so, it is more likely to be a representation. If the statement is made
or repeated just before agreement is reached, then it is more likely to
be a term.

4.4.2 Importance. Sometimes this overlaps with ‘time’. If a statement is
made at the beginning of negotiations and never repeated, it is less
likely to be important to the parties than if it is made just before
agreement is reached. It may be different if an early statement is
made to show that the whole of the negotiations are subject to a vital
point. If a car dealer is told ‘show me only low mileage cars, with
less than 20,000 miles on the clock, because I have found the high
mileage car to be nothing but trouble’, then this may well be said to
set the tone of negotiations even if the customer does not mention
the matter again.

4.4.3 Expertise of the parties. Anything said by a person with special
knowledge is more likely to be a term, because the customer will be
relying on a person such as a dealer to know about the goods on sale.
Thus, in Dick Bentley Productions v. Harold Smith Motors [1965] 1
WLR 623, a garage was told to produce a ‘well vetted Bentley car’.
This was clear evidence of reliance on the garage’s expertise. The
garage produced a car which they further said had done low mileage
since a new engine and gearbox had been fitted. This was not true,
and the garage had not discovered certain gaps in the car’s history.
The court decided a term had been broken.
When in *Oscar Chess v. Williams* [1957] 1 All ER 325, a car owner traded in his car as part of the price for a new one, the court reached a different conclusion. The car owner said that his car was a 1948 model, because that is what the registration book said. Unknown to him, the registration book was a forgery and the car was in fact much older than 1948. The court held that the statement as to the age of the car was a representation. The garage, with its greater expertise, could not claim to be relying on the word of the owner, who had no great knowledge of cars.

It may be noted that in each case the false statement was innocently made. We will see in Chapter 5 why it was important to the plaintiffs to establish breach rather than misrepresentation.

4.4.4 *Writing*. If a contract has been put into writing, then it is presumed to contain all the terms. Anything left out is a mere representation. However, in exceptional circumstances, a court may hold that the contract is partly oral and partly written; 4.5.

### 4.5 Written Contracts: Special Rules

Although contracts with special requirements of writing are rare (11.1 and 11.2), and therefore in most cases oral contracts are fully valid, it is uncommon in business to find a contract by word of mouth only. The reason is partly the complexity of such contracts, requiring the clarification which writing may bring, and partly that without writing it is more difficult to prove to a court exactly what the contract was about.

If you put yourself in the position of a judge or an arbitrator, you can see that a written contract would come as something of a relief; you would have something in front of you on which to base your decision. It would be much easier for you, therefore, to refuse to allow the parties to argue about the contract outside the meaning of the written words. You certainly do not want to spend time hearing arguments which deny the validity of the written words, unless it is absolutely essential to do so to ensure justice is done.

From this, you can see the reason behind the Parol Evidence Rule and the logic behind the exceptions. The Rule states that where there is a written contract, the court will not hear extrinsic evidence (meaning from outside the writing) to add to, vary, or contradict the writing.
The exceptions are all necessary to justice. Extrinsic evidence is allowed where the contract was intended to be partly oral and partly written; where it is necessary to prove that agreement was gained by force or fraud (Chapter 5); where the contract is ambiguous and further explanation is necessary to understanding; where the evidence shows the contract is subject to some condition precedent or subsequent, or reveals a collateral contract. Evidence of an oral agreement preceding a written contract is necessary in order to ask for the equitable remedy of rectification; 5.5 and 7.4.3.

A recent case in Hong Kong shows that the courts are not willing to allow the circumstances in which extrinsic evidence can be introduced to be arbitrarily limited. In *Joseph C. T. Lee & Co. v. Chan Suk-ching* (1986) No. 2384, a written contract contained a clause stating that ‘this agreement contains the full agreement between the parties’. The court nevertheless decided that the agreement must be looked at as a whole to see whether ambiguities existed which would mean that extrinsic evidence should be admitted.

### 4.6 Conditions Precedent and Subsequent

Although we shall meet the word ‘condition’ in its meaning as one type of term of a contract, here it has no such meaning. A condition precedent or subsequent is not a term of the contract at all. It is something outside the contract, on which the existence of the contract depends.

The most usual condition precedent is the need for approval of some kind or the gaining of some permission, whether or not by way of formal licence. A contract may be agreed in full detail. There is offer and acceptance, consideration and intention to create legal relations. However, the parties agree that the contract will not come into operation on formation, but only when the condition is fulfilled. Perhaps you can see that the advantage lies in the fact that, upon fulfilment of the condition, the contract immediately and automatically becomes operational. This is different from simply saying, during negotiation, that no agreement can be reached until certain licences are granted. In that case, even when the licence is granted, agreement still has to be formally reached and could easily be withheld.
In *Joseph C. T. Lee & Co. v. Chan Shuk-ching* (4.5) there was a contract for the sale of a flat and two parking places. There was, however, a condition precedent that the deeds for the car parks should be produced before the contract would take effect.

A condition subsequent is similar in that it remains outside the contract, but it ends the contract when it occurs. If a contract is expressed to be effective ‘until the person qualifies as a solicitor of the Supreme Court of Hong Kong’, then, upon the happening of that event, the contract is automatically ended.

### 4.7 Construction of a Contract

The rule in construing and interpreting a contract should by now be quite familiar. The contract is to be construed so as to find and give effect to the intentions of the parties to it. Recently the Privy Council had to pronounce on a case originating in Hong Kong, *Mitsui Construction Co. Ltd. v. Attorney-General* [1987] HKLR 1076, which concerned a construction contract, involving a tunnel as part of waterworks. It was difficult to reach a decision, because of the complexity of the case and the fact that the contract was badly drafted.

However, the Privy Council stated that the bad drafting did not give any excuse for moving away from the primary duty to put into effect the parties’ intentions as determined from a reading of that contract. They refused to allow comparison with other contracts made in similar circumstances.

Apart from this general rule, there are various rules of construction used by the courts to ensure a consistency of approach. The most important one, and one we shall meet again when considering exemption clauses (8.2), is known by its Latin title of the *contra proferentem* rule (sometimes it is expressed in the plural, as *proferentes*). *Contra* means against, and *proferentem* is a neat way of referring to the person relying on the document — that is, the drafter of it, the *proferens*. Any ambiguities are construed against the *proferens*. That is, the drafter never gets the benefit of any doubt. This is a great incentive to making sure that your drafting is impeccably done.
4.8 Collateral Contract

The word collateral in this context simply indicates a contract which exists alongside a main contract. For instance, a contract of guarantee cannot exist without something to guarantee. Such contracts generally involve the payment of money compensation if certain events occur.

The normal contract of guarantee is entered into deliberately, and is usually in writing (although the law of Hong Kong, unlike the law of England and Wales, no longer requires this). However, sometimes the court may construct a contract where none was specifically entered into. This is usually done where there are three parties; 9.2.6.

Sometimes, a statement made during pre-contractual negotiations is taken to be part of a collateral contract between the two parties. This is unusual, and may be done where it is not convenient to use the remedies for misrepresentation. The device should not be overused, however. In the case of Dick Bentley Productions v. Harold Smith Motors (4.4.3), one judge wanted to find that there was a collateral contract to the effect that the car would be well vetted. The majority decided that this was not necessary, as the term could be seen as part of the main contract. Although it was once said that a collateral contract should not contradict the main terms of a contract, this does not seem to be true any more. In City & Westminster Properties v. Mudd [1959] Ch 129, the collateral contract device was used. Mr Mudd had a lock-up shop on lease from the company. They produced a new lease for him to sign, but he objected, for under its terms he would be prevented from sleeping in the basement (something he had been used to doing). The owners told him that he could continue to live in the basement, and so he signed. The owners then brought an action to forfeit the lease, because of the wrongful use of the basement as living quarters. Mudd was able to establish that the promise made to him was part of a collateral contract. In consideration of it, and in reliance on it, he signed the main contract.

It may be seen that the promise could not be part of the main contract (since it contradicted it) even if the court had been prepared to allow the contract to be partly oral and partly written. Misrepresentation could not produce the correct result. Only the device of collateral contract allowed the court to give the most effective remedy in all the circumstances of the case.
4.9 The Relative Importance of Terms

The terms of a contract can only be identified once we have disposed of the other possibilities, as we have done above. At this stage, we know that what we are looking at are terms of the contract, and that if these terms contain promises which are not performed or statements which turn out to be incorrect, an action for breach of contract will follow.

The further problem to face us is, however, that the common law of contract has two different remedies for breach of contract. One is money compensation, damages (7.2). Damages are available for any breach of contract and only the amount remains to be settled.

However, in some cases it may not be appropriate to ask for damages. I may realize from your poor performance that I do not wish to continue with our contractual relationship. Perhaps you are a builder or a decorator, and your work is clearly appalling from the start; perhaps you are an accountant and your work is full of errors. I do not wish to continue to the end of the contract and then ask for compensation. I wish merely to end the contract as soon as possible, without performing my side of it. I may or may not require damages as well.

Thus, on breach of a contract, the remedy may be damages only, or it may be a right to treat the contract as discharged because of the other party’s breach of contract. If the latter, then damages may be awarded in addition to the right of discharge, depending on the circumstances.

The problem lies in knowing which breaches of contract give rise to which remedies. Two methods of making the decision exist, the traditional method and the modern method. Today, the two have been rationalized into one system, to a large extent.

4.9.1 The traditional method: conditions and warranties. This division was first clearly made in the original English Sale of Goods Act 1893 (since replaced by the 1979 Act). In Hong Kong, our Sale of Goods Ordinance (Cap 26), from now on called SOGO, reproduces that division. Although these pieces of legislation apply only to sales of goods (where ownership of goods is exchanged for money), the division was adopted by the courts in all contracts, for no firm guidelines were to be found elsewhere, and the legislation in many cases simply reproduced existing common law. So it can be said that the common law has a concept of conditions and warranties.
SOGO s13 is the main section dealing with the division into conditions and warranties. A condition is an important term, embodying matters central to the contract. A warranty contains collateral matters merely.

Breach of condition entitles innocent parties to behave as though the contract had been repudiated by the other party (that is, treat themselves as discharged from all their own obligations), and also claim damages if need be.

Breach of warranty entitles an innocent party to damages only and not to repudiate.

It should be pointed out that the remedy for breach of condition is not compulsory, and is easily lost. That is, the ending of the contract is at the choice of innocent parties, and they may elect to take only damages if it suits them to do so. In any case, if innocent parties show an intention to continue with the contract after breach, then this shows that they have elected to treat the breach of condition as a breach of warranty only.

Distinguishing between condition and warranty is done by looking only at the contract itself. If we imagine that we have a written contract before us now, we will go through it in our imagination, checking each clause. We read clause one, and ask whether, in our opinion, at the time of contract the parties would have said that this was a term central to the contract as a whole or not. We are not allowed to use hindsight. That is, we must confine ourselves to the time of contract and must not use what we actually know about the circumstances surrounding the breach of the contract. We do this for every clause. Note, however, that according to Schuler v. Wickman [1974] AC 235, what the parties have called the clause is not decisive. This is because the parties do not necessarily know how to use the words in the sense prescribed by SOGO. After all, we have seen at least one other use of the word ‘condition’ — in conditions precedent and subsequent; 4.6. Also, as the Court pointed out, sometimes ‘condition’ is a word used to mean no more than ‘term’. How many tickets have you seen which say ‘for conditions see back’, and how many documents are headed ‘terms and conditions’?

This method has its disadvantages, and most of them come about because to use it we deliberately shut our eyes to knowledge which we actually have. In most cases it is true that, if an important term is broken, the result will be drastic, whereas if an unimportant term is broken, the results will be trivial. But there is no flexibility in
this method, because it does not allow for the unusual case. For example, a term can be technically broken, with no loss resulting. If that term is clearly, on the construction of the contract, to be classified as a condition, then the contract can be set aside. In *Arcos v. Ronaasen* [1933] AC 470 the contract specified ‘half-inch staves’. The staves which were delivered varied minutely from the half inch. The buyers rejected on the grounds of breach of the term that (in sales of goods) the goods delivered must be precisely the same as the contract description. Yet the buyer could have used the staves for making barrels, the purpose for which they were bought, with no problem at all.

4.9.2 *The modern test.* The modern test came about because of dissatisfaction with the idea of making a decision on only part of the knowledge held by the judge, and it began in a case called *Hong Kong Fir Shipping v. Kawasaki Kisen Kaisha* [1962] 2 AC 26. Lord Diplock stated that the test he wished to use involved taking into account all factors, including circumstances involved in the breach of contract, and asking the following question: ‘Has the innocent party been deprived of most of the benefit which he expected to get from the contract?’ If the answer is ‘yes’, then the breach is treated in the same way as breach of condition. If the answer is ‘no’, then the remedy is damages only, just as for breach of warranty.

Lord Diplock described terms which he subjected to this test as innominate terms. Innominate simply means without a name. Certain terms cannot be pre-classified. In the *Hong Kong Fir Shipping* case, the term in question was seaworthiness. Like roadworthiness, the term covers a whole spectrum of faults. A ship may be unseaworthy if it is a rotten and holed hulk; however, it may technically be unseaworthy because of a couple of missing rivets. Such a term obviously cannot be successfully pre-classified, and it makes a great deal of sense to look at the whole picture, and ask the question which Lord Diplock asked.

This totally different approach is also useful where it is not so much the breach of a term which matters, as the breach of a whole contract. If, for example, we look at a case from the early days of aerial advertising, we see an example. In *Aerial Advertising v. Batchelor's Peas* [1938] 2 All ER 788 an aeroplane, hired to publicize a particular brand of peas, flew over the cenotaph when the town was observing its annual solemn silence in memory of the war
dead on Armistice day. We can see that the effect would be to create an unfavourable impression of the peas, but it is hard to point to exactly which term had been broken. In applying Lord Diplock’s test, we can see that the innocent party was deprived of all the benefit it expected from the contract by the circumstances of the breach.

At one time, there was a tendency to talk of breaches which were fundamental or not fundamental, but the concept of fundamental breach led to bad decisions, so it has fallen into disfavour; 8.8.

4.9.3 Lord Denning was responsible for integrating the tests in *Cehave v. Bremer (the Hansa Nord)* [1976] 1 QB 44, and other cases have provided guidelines as to how to use the integrated test. In *Cehave v. Bremer*, Lord Denning suggested that even in sale of goods cases, there were three types of terms: conditions, warranties, and intermediate stipulations. Conditions and warranties use the traditional test, and intermediate stipulations use the Diplock test, but both are present in any contract; we need not choose to operate one test and ignore the other, for we simply decide which test is appropriate to which term. In this case, citrus pulp was to be shipped ‘in good condition’, but had deteriorated. The buyer claimed to reject and then bought it later at a lower price, because it could still be used for animal feed. Lord Denning said that the deterioration should not have been classed as a breach of condition, for the result of the breach required only a lowering of the price — something which is the effect of damages when properly assessed.

The result today is that the following remain conditions or warranties:

1. Breaches of the implied terms of SOGO (Cap. 26) ss 14 to 17; 4.10 and *Goods*. However, according to the courts, what lies within these implied terms should now be fairly narrowly construed, so as to allow the courts to use their discretion in most cases.

2. Breaches of time clauses, where time has been made ‘of the essence’ of the contract, or is implied to be so. This is because, apart from matters like delivery in commercial contracts, the time or date for performance in a contract is not important unless it has been made so by the parties. They can do so by using phrases such as ‘on or before’ or ‘by 14 March and no later’. The result is that a time clause will always be a condition
or a warranty, never intermediate. Business people prefer certainty and you will see the relevance of this if you imagine that you have ordered a taxi to take you to the airport, to pick you up by 8:30 a.m. It is 8:35, and the taxi has not arrived. You are worried, and have no means of knowing exactly how late it will be. You can still get to the airport if you jump on a bus immediately. If you have any sense, you jump on that bus. You do not wait until it is clear that you have lost any benefit which was to be expected from the contract. On the other hand, if you mention a time but do not make it ‘of the essence’, the lateness of the other party does not allow you to refuse to accept performance at a later time.

3. The agreement of the parties. We have seen that, according to Schuler v. Wickman (4.9.1), it is not enough to call a term a condition. If, however, the parties explain what is to happen on breach, then it is difficult to imagine that the courts could enforce anything other than that which the parties have agreed to do. So a cancellation clause may be used. This is a clause which says clearly that if X does not do as X promised, then Y may cancel the contract.

### 4.10 Implied Terms

All the terms of a contract need not be spelled out. Whilst it is true that a contract may fail for uncertainty, the courts will not see a contract fail if it is possible to find meaning. Sometimes meaning is found by way of implication of a term which the parties must have meant to include, but which they did not include in so many words. This is a difficult area, for the courts refuse to help the parties by rewriting their contract; the job of a court is simply to find the meaning given to the contract by the parties themselves. If no such meaning can be found, the contract must fail, in the last resort.

Implication occurs in two basic ways. First, a term can be implied because the contract belongs to a particular type of contract, and in this type of contract certain terms are generally included. In such a case, it will be assumed that, unless the contrary is shown, the parties in question also intended to include the term. This is rather like picking a garment from a rack of clothes intended to fit a range of people.
The second way involves something more like a tailor making a specific garment to the specific measurements of one person. For, in this case, the court implies a term which is unique to this one contract.

4.10.1 Implication into a type of contract. This occurs in a number of ways. One way is trade usage. People in the same business develop a way of understanding each other in a language incomprehensible to outsiders, either because of special jargon words, or simply because of short, allusive language. A contract made by such people may well be puzzling to outsiders. However, the court will take evidence to show whether the contract would have been perfectly comprehensible to those in the trade. Sometimes a custom grows up as to remuneration. Perhaps a broker in a particular trade is normally given a 3 per cent commission. In such a case, a contract which did not specify any commission would not be void for uncertainty, for the courts would decide that 3 per cent must have been intended by the parties. If the contract specifies 2 or 4 per cent, however, the court must abide by this. Trade usage can fill gaps, but cannot override clearly written or spoken provisions.

In these cases, the courts may even imply entire standard form contracts. Where two parties are in the same trade and both normally use the same standard form contract, then if they make a fairly vague agreement over the telephone one day, the court is likely to hold that the basis of the contract was intended to be that standard form contract. In British Crane Hire v. Ipswich Plant Hire [1975] QB 303, a crane hired by one company to another by a telephone call was damaged in use. The contract normally used by both parties was implied by the courts in order to decide who bore the loss.

One important area in Hong Kong law is the implication of a term of fitness for purpose into hire contracts. In Hong Kong, we still do not have the long-promised Hire-Purchase Ordinance, and so it seems that any implied term as to quality in hire-purchase contracts must be the term referring to hire in general. According to Read v. Dean [1949] 1 KB 188, a term is implied that goods which are the subject of hire contracts are as fit for their purpose as ordinary care and skill can make them. This really only promises lack of negligence, and is inferior to the absolute promises of fitness in SOGO. Further, the term is freely excludable because, like the trade usage terms, it only applies if the parties do not express a contrary intention.
Another important area at common law is the implication of a term into contracts of work and materials that goods so produced will be reasonably fit for their purpose. Again, the clause is not very strongly worded, and again it gives way to contrary intention. Sometimes it is difficult to tell the difference between work and materials contracts and sale of goods contracts. The difference is one of emphasis. If I employ a famous artist to paint my portrait, then I am contracting for her skill in the act of painting, and the contract is work and materials. If I buy a cheap oil painting of ‘Junks in Hong Kong Harbour’ from a stall in Tsim Sha Tsui, it is certainly simply a sale of goods. But if I am the owner of such a stall, and I pay a number of local artists to produce as many ‘Junks in the Harbour,’ ‘Junks at Sunset’ and ‘Hakka Ladies in Hakka Hats’ as they can manage — what am I paying for? The finished product for resale, or the skill going into it? It is hard to tell. England’s Supply of Goods and Services Act 1982 has performed a needed function in simplifying this sort of problem, especially the sort of case where I buy goods such as air conditioners and then have them installed. Sale of goods or work and materials? The Act gives fairly clear guidelines. We in Hong Kong have no such legislation and have never developed clear guidelines at common law.

It is still possible for new kinds of terms to be implied. A recent case concerns a recent phenomenon. The House of Lords in Liverpool City Council v. Irwin [1977] AC 239 implied a term into all contracts between landlords and tenants of multi-storey flats that, if nothing was said to the contrary, the landlord had promised to take reasonable care of the lifts, staircases and other common parts.

The only terms of any great importance implied by legislation in Hong Kong are those in SOGO; Goods 4. All these terms are specified to be conditions or warranties (4.9.1) and are in contracts where goods are sold (that is, ownership changes hands) for money. The terms operate between buyer and seller, and the fact that the seller is not the manufacturer and has not been negligent is irrelevant. Sellers are absolutely responsible to buyers for the state of the goods, and if need be must in turn sue those who supplied them. This is because the privy rule makes it impossible for buyers to sue their sellers’ suppliers in contract, although an action in tort may be possible; 9.1. Further, the terms implied by SOGO do not follow the common law rules, in that their implication may be against the seller’s express wishes. In Chapter 8 we will consider the rules
restricting exclusion of the implied terms. This is a considerable concession to the consumer, and an assistance to the small business; Goods 4.

The terms are as follows:

By s14 a condition that the seller has the right to sell the goods. This means that the buyer can claim a complete refund, even after several months’ use, if the goods are reclaimed by a true owner.

This section also contains some minor warranties.

By s15 a condition that goods will answer their description. Thus, if goods are described as new, they must not be second hand, and if goods are described as red, they must not be blue. If the goods are not as described, it is no defence that they are perfectly usable.

By s16 a condition that goods will be of merchantable quality and will be fit for any special purpose which is made known to the seller. This section is unlike the others in that it only applies to sales by a professional seller. The other sections apply to all sales, including private ones.

There are some slight exceptions, in that goods will not be unmerchantable because of defects which were drawn to the attention of the buyer or where the buyer conducted a pre-contractual inspection which should have discovered the defect. The fitness for purpose section does not apply if the seller shows the buyer did not rely on the seller’s skill and judgment. Thus if the buyer insisted on purchasing a particular brand, or otherwise ignoring advice from the seller, then the buyer could not blame the seller if the goods were unsuitable.

Also, the term as to merchantability is relative. Sale goods or secondhand goods must be merchantable, although they may not be as good as new goods.

This section gives a great deal of protection to consumers, because the sections cannot be excluded by the seller against a consumer.

By s17, when goods are bought by sample, they must be equal to sample. This protects buyers who have bought a large consignment of goods on inspection of a small sample, and the term is a condition of the contract. The contract must be expressly or impliedly a sale by sample. That is, the condition does not operate just because a sample is shown during negotiations. There must be an intention to base the contract on sale by sample.
4.10.2 *Implication into individual contracts.* This is very rare. It is far better to draft a proper contract in the first place than to beg the court to fill a gap which you find you have left.

*The Moorcock* (1889) 14 PD 64 is the first important decision. A shipowner contracted with the owner of a jetty to tie up there. The jetty was in tidal waters, and at low tide the ship sank and broke her back. Nothing was said in the contract about responsibility in these circumstances, but the court decided that it must have been intended that a term of the contract would be that the jetty would be a safe mooring place at all stages of the tide.

This decision was made on two grounds. One was business efficacy. That is not a misprint for efficiency, and does not mean the same thing. The point is that the term must make the difference between the contract failing and remaining in action. It is nothing to do with making it reasonable or fair. The second ground was the intentions of the parties. This was lost sight of in later cases, as counsel no doubt found it convenient to bring in implied terms whenever a really hopeless case was getting near its end.

Because of this, *Shirlaw v. Southern Foundries* [1939] 2 KB 206 introduced the officious bystander. You are simply to imagine that the parties are on the point of agreement in the original contract. Just then, a busybody who has been listening to the conversation (let us take *The Moorcock* as an example) asks: ‘What about low tide? Will the ship be safe? You haven’t mentioned that at all.’ If you can imagine that the parties would have turned on him and said: ‘But it goes without saying! We only haven’t mentioned it because it’s obvious. The fact that the jetty must be safe at all levels of tide is the basis of our discussions. Things as important as that need not be said.’

This test is simply a way of letting you ascertain the intentions of the parties by a bit of role-playing. If you do not find it helpful, simply ask what the intentions are likely to have been before the contract was made (and the crisis occurred).

It cannot be stressed too much that the courts do not use the implied term to indulge in notions of how they would have written the contract, given the chance. It must arise normally and naturally out of the circumstances. In the recent Hong Kong case *Associated Recoveries (Orient) Ltd. v. Ashby* (1987) No. 41, money had been advanced to the defendant during his time as the director of a company. The court decided that the payments were in fact
advances against future dividends. There was no express agreement as to what should happen if the defendant left the company at an early stage. The court decided that the intentions of the parties must have been for repayment in these circumstances, for it could not have been the intention of the parties that he would not repay the money if he did not earn it by service to the company.

4.11 The Battle of the Forms

In 3.5.4 we drew attention to one problem which arises when both negotiating parties use standard forms, the problem of which are offers, which acceptances, and whether a contract has been made. Here we consider the other question: assuming there is a contract, what are its terms? More particularly, does the plaintiff’s or the defendant’s form provide the terms, or can you construct the contract from bits of each? In Butler v. Ex-Cell-O [1979] 1 All ER 965, the sellers offered to supply goods ‘on our terms which shall prevail over buyer’s terms’. The buyers replied by sending an order worded 'subject to our terms and conditions'. This included a tear-off slip for the seller to sign, containing an acknowledgement that 'we accept the order on your terms'. The sellers completed the tear-off slip and sent it back, saying ‘the order is entered into in accordance with our quotation’ — that is, the original offer. The English Court of Appeal held that there was a contract on the buyer’s terms. The tear-off slip destroyed the terms in the original quotation. The sellers’ accompanying letter was not a clear enough statement of refusal to accept those terms, when placed alongside the tear-off slip.

Points to Note

1. Statements made between the parties during negotiations may be mere puffs, representations or terms; or they may be conditions precedent or subsequent; or they may create a collateral contract (Figure 1).

2. A puff is a statement which has no contractual significance.

3. A representation is not a term. It is not intended to be a part of the contract. It may if false have legal significance.
4. The remedies for a broken term always include damages but for a false representation they may not.

5. Whether a statement becomes a term depends on the intentions of the parties. The Court seeks that intention by applying guidelines.

6. It is more likely that the parties intended a statement to be a term if it was made at the time of the contract rather than long before.

7. It is more likely to be a term if the parties treated the statement as important.

8. It is more likely to be a term if made by a party with expert knowledge.

9. A statement made outside a written contract is not likely to be a term.

10. Extrinsic evidence is not usually admissible to add to, vary or contradict a written contract: the parol evidence rule.

11. Conditions precedent or subsequent are not terms.

12. A contract is so construed as to find the intentions of the parties.

13. Any ambiguity is construed against the party responsible for the drafting of it: the *contra proferentem* rule.
14. Where justice requires it, the court may find a collateral contract.

15. The need to put terms into categories arises because different remedies attach to their breach.

16. A condition is an important term; its breach allows (but does not require) the injured party to repudiate the contract, as well as claim damages.

17. A warranty is a less important term, breach of which does not allow repudiation.

18. A contract may state expressly what status a term shall have.

19. Where the status of a term is not fixed, expressly or impliedly, it is an innominate term. Breach of an innominate term will be treated as a breach of warranty unless the injured party can show that it has ‘been deprived of most of the benefit which it expected to get from the contract’.

20. SOGO imports terms into contracts for the sale of goods. They are either conditions or warranties: conditions that the seller has a right to sell, that the goods answer the contract description, are fit for their purpose and of merchantable quality, and (if it is a sale by sample) are equal to sample; warranties that the buyer will have quiet enjoyment and will not be disturbed by undisclosed claims; *Goods*.

21. A time clause is only a condition if time is made ‘of the essence’, otherwise it is a warranty.

22. Implied terms may be incorporated into a contract because it is of a type which usually contains such clauses, e.g., by trade usage.

23. A term may be implied where necessary for business efficacy, i.e., to make the contract work, if it clearly meets the intentions of the parties when they made the contract.

24. An implied term always gives way to an express intention, except that SOGO’s implied terms of fitness for purpose and merchantable quality cannot be excluded from a consumer sale.
25. When both parties try to insert terms by using their own standard forms, the Court must first decide whether there has been any agreement. If there has, the meaning must be sought by construing all the documents together.
Chapter 5

Defective Contracts

5.1 Vitiating Factors

We have seen that what usually matters is the appearance of agreement, and that we may find a hasty agreement binds us to something we do not want. There are some cases, however, where a person who says ‘This is not what I expected!’ can get out of the contract. These occasions are rare, however, and it is not every disappointing surprise which gives rise to them. In Hong Kong law, we find that we must fit our facts into one of a small number of categories, usually referred to as ‘vitiating factors’ in the textbooks.

Before looking at those categories, it must be said that there are two possible effects of the vitiating factors. The most usual one is that the contract becomes voidable. This is a matter between the parties, and cannot give any help if third parties have become involved. Rarely a contract can be made void and this affects all parties. For example, supposing someone, by a trick, persuaded you to sell your bicycle in exchange for a cheque which was not met at the bank. If the buyer still had the bicycle, you could take it back and it would not much matter whether the contract were void or merely voidable. But if the buyer had sold the bicycle to a third party, who knew nothing of the bouncing cheque episode, then to get your bicycle back from the third party would be very difficult. You would have to prove that the original sale by you was void. If it was merely voidable, then the innocent third party’s rights would be protected above yours.

We have put the end at the beginning, because so many students lose their heads when faced by the vitiating factors. They forget what the purpose of proving the existence of such factors is, and become too involved in the details. Bear in mind that what is happening is an attempt by someone who has got much the worst of a bargain to find some avenue of escape; and bear in mind that such paths are hard to find, and narrow and rocky once found.
5.2 Misrepresentation

This factor is often met with in real life. It arises where someone is misled by a statement of another person, and we have already seen how difficult it sometimes is to tell the difference between a term of the contract and a representation; 4.4.

We are not concerned at first with the motive for the misrepresentation, for we have a number of points to check. The statement might be: ‘The car has only had one owner’ or ‘This book provides all the information you need in order to build your own air conditioner’. The first thing we do is to check the statement against the following definition:

A misrepresentation is an untrue statement of fact, made by one contracting party to the other, which statement was intended to, and did, induce the other party to enter into the contract.

If we take this statement apart, piece by piece, we will discover what it is we need to prove to show that a statement is an effective misrepresentation.

5.2.1 An untrue statement. A statement has to be made. Silence is not misrepresentation. However — it depends on what you mean by silence. Quite a long time ago, the point was made very well in Walters v. Morgan (1861) 3 De GF & J 718: ‘a single word, or (I may add) a nod or a wink or a shake of the head, or a smile from the purchaser intended to induce the vendor to believe the existence of a non-existing fact, which might influence the price’ would amount to a misrepresentation by conduct. Imagine that a bookshop is advertising discounts to students in certain tertiary institutions. You do not belong to one of the listed institutions, so you borrow a T-shirt from a friend who does. The T-shirt announces something like ‘School of Law, City Polytechnic, Opened October 1988’. You say nothing, the shopkeeper glances at your shirt and gives you the discount. By your conduct you have made a statement, as well as by your T-shirt. There is no need to speak — this is misrepresentation.

Beware of the logic of the half truth. This is something children use when they say something like ‘But it wasn’t untrue! I said I didn’t hit him, and I didn’t. The stone that I threw hit him, not me’.
To maintain that ‘I didn’t hit him’ in these circumstances amounts to a half truth. That is, the statement is literally true, but misleading. There is no requirement to speak at all, as in *Fletcher v. Krell* (1873) 42 LJ (QB) 55 where it was held that a woman interviewed for the post of governess was not required to tell of her divorce, if not questioned about her marital status. However, once a person begins to speak, disclosure must be full and frank. In *Dimmock v. Hallett* (1866) 2 Ch App 21 the purchaser of land wanted to know if the farms upon it were let. The vendor, knowing that the purchaser wanted the answer ‘yes’, gave it to him unequivocally, without mentioning that all the tenants had given notice to quit. This is a half truth, in that it is literally true, but does not go far enough and thus leaves a false impression.

Connected with this, is the need to correct statements. If negotiations drag on, a statement made at the outset may no longer be true. It is no defence to say: ‘Ah, but the statement was true when I made it.’ There is a duty to update the statement. An example is *With v. O’Flanagan* [1936] Ch 575. A doctor sold his practice. At the start of negotiations he stated, truly, that his practice was worth a particular sum per year. However, as negotiation went on, the doctor became ill and his practice dwindled. Thus, when the contract was finalized, his statement was no longer true. It was held that he was liable for misrepresentation.

There are certain cases when silence is equivalent to misrepresentation. Where there is a duty to speak, then silence is wrongful. Such cases include the special relationship, known as the fiduciary relationship, and certain contracts said to be *uberrimae fidei*, ‘of the utmost good faith’. If a contract is *uberrimae fidei*, full disclosure is necessary. The main example is contracts of insurance. The insurer takes a great risk, so when you want, say, life insurance, it is your duty to make sure you tell the insurer everything a reasonable insurer would need to know in order to decide on your case. If you keep anything hidden, even if the insurer did not ask about it, you face having your insurance avoided at a later date, even if the claim you want to make has no connection with the information you did not give.

5.2.2 An untrue statement of fact. What is meant by a statement of ‘fact’?

1. Not law. A statement such as ‘SOGO s16 protects your rights, so there is no need for a guarantee’ would be false in the case of
a private sale (for s16, alone amongst the sections, only applies when the seller sells in the course of a business). Or what about a statement such as: ‘There is planning permission to develop this site’? Every citizen is taken to know the law, and a mis-statement of the law has no effect. A false statement as to the effect of s16 therefore would not be a misrepresentation. Or would it? Few statements are made in a vacuum. If you look at our second statement you will see that, although it concerns the planning law of the district, it is about a particular site. It could be said to be a statement of fact as applied to the site. The courts have classified this as ‘mixed law and fact’ and treated it as fact. The statement about s16 is purer law, but even so, gives us a statement about the particular goods involved. How do you think the courts would treat it? In general, the courts do not like to be deterred from doing justice by the ‘statement of law’ restriction. In *Cooper v. Phibbs* (5.4.1) the court held that the meaning of a will was a matter of law, but the way in which it applied to the rights of a person was a matter of fact.

2. Not opinion, not intention. When I give an opinion, I am venturing on uncertain ground. So if I preface my statement with something like ‘I think’, ‘in my judgment’, ‘it seems to me’, I am in effect telling you that your guess is as good as mine. So in *Bisset v. Wilkinson* [1927] AC 177 a tentative statement by a seller of land as to the number of sheep the land could support was held to be mere opinion. It helped that the vendor had never kept sheep and clearly phrased his statement as an opinion. However, it should not be imagined that the court will let any lively rogue get away with the indiscriminate use of tentative words before a definite statement. Furthermore, if a statement betrays an opinion no reasonable person could have held, it is a statement of fact (for the person is making a misstatement about his opinion). Similar rules apply to intention. When I state my intention, I am stating only my present state of mind, and there is no guarantee against change. But if I state an intention when it is not in my mind, then I am making a misstatement of fact, for ‘the state of a man’s mind is as much a fact as the state of his digestion’, as judges like to put it.

5.2.3 *Made by one contracting party*. The statement must be made by or on behalf of a contracting party. If it is made by a third party, we are
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5.2.4 The statement induced the contract. The statement will be of no effect if it was never heard or read by the party to whom it was addressed (for instance, it was contained in a letter which never arrived) or if it was heard, but was ignored, or checked up on. In *Attwood v. Small* (1836) 6 Cl & Fin 232, a mine was to be sold, and the seller made statements as to its capacity. The sceptical buyer ran a check and decided the statements were true. However, the statements were not true, and the buyer discovered this after contract. He was unable to claim misrepresentation, as he had relied on his own investigations and not at all on the buyer’s statement.

However, it must be noted that the buyer’s check was voluntarily undertaken. If the buyer chooses not to investigate the seller’s statement, this is the buyer’s privilege, and the seller cannot be heard to say that a check would have uncovered the true position. This is the meaning behind the case of *Redgrave v. Hurd* (1881) 20 Ch D 1, concerning the sale of a solicitor’s practice. The solicitor misrepresented his earnings, and it was no defence to say that the buyer should have examined the books of the business.

We must not take ‘inducement’ to extremes. Whilst it is true that the victim of a misrepresentation will often say ‘if I had known the truth I would never have entered the contract’, this is not the test. It is enough that the misrepresentation proved to be part of the reason for entering the contract; it is not necessary that it be the whole reason.

5.2.5 The place of fraud. Many students assume that misrepresentation is always fraud and always based on a lie. This is not the case, and you will have noticed that, in our anatomy of a misrepresentation, fraud is not mentioned. That is because the statement must be false to be a misrepresentation, and at that stage we do not care why it is false.

It is important to look at fraud when we come to the question of remedies. This is because originally, whilst the equitable remedy of rescission was available for any misrepresentation, the only damages for misrepresentation lay in the tort of deceit. Deceit requires fraud. Thus, if a party failed to prove fraud, the remedies were
fewer. Even when it comes to rescission, the fact is that a party proving fraud will have a better chance of persuading the court to set the contract aside; 5.3.3. The task of proving fraud is not an easy one, and the classic case is *Derry v. Peek* (1889) 14 App Cas 337. A company made an untrue statement in circumstances which many would say was foolhardy. They wished to change from horse-drawn to steam driven trams, and were in the process of getting government permission to do so. They thought that the final stage was merely a ‘rubber stamp’ procedure, and in their company documents they claimed that they had permission, although they had not finished the process. This was not deceit. There was no intent to deceive anyone (they thought what they said was true). They may have been careless, but they had not been reckless. The difference between the two states is hard to pinpoint, as it is more of a sliding scale than two distinct states. Bear in mind that it will always be hard to prove fraud, because that may lead to a criminal prosecution.

### 5.3 The Remedies

5.3.1 *Rescission.* This is an equitable remedy and is available whether or not fraud is proved. It involves putting the parties back into their pre-contractual positions. That is, goods are given back, the price is returned. However, the remedy is not always suitable, and it will not be granted:

(a) If the innocent party has shown an intention to continue with the contract. For this reason, it can be dangerous to compromise, to accept repairs, for by so doing the equitable bar of affirmation is activated.

(b) If the innocent party delays too long before seeking rescission. This is technically known as laches; 8.7.4. Clearly, laches is involved if a person finds out about the misrepresentation but then spends too long before seeking a remedy. This could eventually shade into affirmation, although affirmation requires positive adoption of the contract. Laches has also proved a bar in the case where a person spends too long before discovering the misrepresentation. In *Leaf v. International Galleries* [1950] 2 KB 86 the court held that, after a picture had been hanging on a wall for some time, the fact that it was not a genuine Constable should have been discov-
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The picture had, in fact, been there for five years, and the claim was barred by laches. This was, however, a claim where the representation had been innocent, and laches by itself is not a defence in a case of tort.

(c) If restoration is impossible. Sometimes it is not possible to return to a pre-contractual position. If I buy material from you and make it into garments, it is now not possible to return to our pre-contractual position. Generally financial adjustments will not be made over and above simple restoration. A very few cases have allowed this, but such cases involved a special relation of trust known as a fiduciary relationship, and this is not usually involved in a misrepresentation case; 5.6.3.

(d) If third party rights have arisen. Equity will not upset the rights acquired for value in the subject matter of the original contract, as long as the third party was not aware of the problem affecting the original contract. The classic case occurs where a rogue, giving a false name and a false cheque, persuades a seller to part with property — often a car. By the time the bank returns the cheque, the rogue has sold the car to an unsuspecting third party. Equity will not allow rescission in these circumstances. Damages for fraud may be possible — if the rogue can be traced.

5.3.2 The indemnity. Rescission may involve an indemnity for expenses required by the contract. For example, the return of licence fees or taxes which were required to operate under the contract. Students often have difficulty with this concept, but what is required is to ask yourself what expenses would have been necessary whether the contract was voidable or not. These are the subject of the indemnity, since they are caused by the contract and not by the misrepresentation. In Whittington v. Seale-Hayne (1900) 82 LT 49, the sale of a farm was subject to a misrepresentation that the farm was in a sanitary condition. When it proved not to be, rescission was granted, and included an indemnity for rent and rates paid under the lease and repairs undertaken under a covenant in the lease to do so if required by the local authority. These were expenses occasioned by the contract. But the farmer got nothing for all the inconvenience and loss involved to his family, employees, and stock during the time the lease had lasted. No damages were recoverable, just an indemnity.
5.3.3 Choosing the remedy. Rescission is the option of the innocent party, and can never be sought by the misrepresentor. However, even for the innocent party, it is not compulsory. It may be that it is not necessary. If you make a contract to buy a computer, and then discover a misrepresentation before money or goods have changed hands, you may simply avoid. The contract is voidable. That is, you may tell the seller that you refuse to continue on the grounds of misrepresentation. Avoidance plus rescission is only necessary where there has been some performance. In some cases, someone may simply defend an action for breach of contract by pointing to a misrepresentation.

Sometimes, however, a person may wish to keep the goods (say) involved in the contract. For instance, you might buy a car under a misrepresentation as to its age. When you discover the truth, you might say: ‘The car is fine, for its age. However, I have been overcharged.’ The remedy you would want is not really rescission — simply damages.

Until the Misrepresentation Ordinance (Cap 284), damages were not available for a non-fraudulent misrepresentation. The growth of the tort of negligence has afforded another action for damages where negligence can be proved, but this action was in its infancy when the Misrepresentation Act 1967 (on which our Ordinance is based) was introduced in England. The Ordinance has made an action in tort for negligent misrepresentation of little importance; 5.3.4.

As we know, for fraudulent statements, the tort of deceit was always the way of proceeding for damages. The Ordinance introduced damages where deceit could not be proved. Some text books refer to ‘negligent misrepresentation’, but that is misleading, and should be kept for an action in the tort of negligence. Under Misrepresentation Ordinance s3(1), the burden of proof is changed around. Let us say that you have bought a picture, after being told that it is a genuine Chinnery. The statement does not appear in your written contract, and is not a term of the contract. You cannot prove fraud — where are you to get the evidence of ‘wicked mind’? Unless you launch some kind of prosecution and get the police involved, your chances are slim. You decide, however, to proceed under s3(l). You need now only prove the usual things involved in the definition in 5.2. After that, it is for the sellers to prove that they believed that what they said was true (honesty) and that up to the time of contract,
they had reasonable grounds for that belief. You may see why this is called ‘negligent’ misrepresentation by some. For the sellers have to show that there was no carelessness involved in the making of the statement. It is clear therefore that s3(1) applies to innocent, but careless, statements. It can also be used for fraudulent misrepresentation, if a party chooses not even to try to establish fraud.

Section 3(2) applies to any non-fraudulent misrepresentation. It is complicated by the fact that it is said to apply ‘in lieu of rescission’. This appears to mean that if the right to rescind is lost, then so is the right to s3(2) damages. When would s3(2) damages be useful? This would be the only possible way of getting damages where the sellers in my example above could show genuine grounds for the belief that the picture was a Chinnery — an expert opinion delivered before the sellers themselves bought the picture, for example, or the fact that it was bought from a museum. In that case, the only hope of damages is s3(2), for, remember, ‘reasonable grounds’ for belief is fatal to a claim under s3(1); Goods.

5.3.4 Negligent misrepresentations. There is also the possibility, today, of a claim in the tort of negligence. Unfortunately, the area is somewhat tangled. The reason is that in 1967, when the English Act on which our Ordinance is based was passed, negligence had not developed to its present form. It is only since Hedley Byrne v. Heller [1964] AC 465 that an action in tort for negligent statements was allowed to recover for financial loss, and it was much later that the tort was extended to pre-contractual statements. Even now, it is almost always better to use s3(1) rather than the tort, for under the tort the plaintiff has to prove everything, whereas under the Ordinance it is the defendant who must justify the misrepresentation.

Before continuing, we should note that contractual damages only exist for breach of contract. By definition, misrepresentations are not breaches of contract, because they fall short of being terms. In misrepresentation we sue in tort or on the Ordinance. That is why courts will not award damages for any of the other matters involved in this chapter. The companion volume in this series, Professional Liability, explains the meaning of tort in general and negligence in particular in the context of the liability of accountants for negligence.
5.4 Mistake

This takes up an inordinate amount of space in the average contract textbook or course but not in real life. The only reason that it remains alive and kicking is that, of all the vitiating factors, this is the only one which operates at common law to render a contract void. Remember the equitable bar in 5.3.1(d). If mistake, operative at common law, had been proved, the third party rights could have been set aside. But because this is such a ruthless action and does violence to trust in commerce, it is rarely granted.

Mistake has many theories, and most of the textbooks agree on some kind of core. However, it is certain that today, given absolute authority to invent some new kind of code, no one in their senses would choose to retain the complicated and nonsensical rules of mistake.

First of all, mistake is a misleading word. Forget the normal English meaning, and accept ‘mistake’ as a technical word. Perhaps, for once, we would have been better off with a Latin phrase.

Mistake is always related to the formation of the contract, and can sometimes be reduced to sheer lack of subject matter. There simply is nothing to contract about. At other times mistake will amount to lack of consensus, since the offer made is not the offer accepted; 3.2.1.

5.4.1 Want of subject-matter. This area has been classified as Common Mistake, meaning a shared mistake, one which is held in common. Do not confuse this use of the word ‘common’ with its use in the phrase ‘common law mistake’.

If we say that a mistake is operative at common law, we mean that the contract is rendered void. The classic definition looks at the effect of the mistake on the minds. However, for all practical purposes the mistake will only be operative at common law, which is a way of saying that the contract will be void, if there is no subject matter. Thus, we are agreeing on the hiring of a particular computer system; unknown to both of us, the system has been destroyed in a blaze during our negotiations. There is no foundation for our agreement, and the contract is therefore void.

Note that if the system had been destroyed after our agreement but before performance, then we would have been talking about frustration; 6.6.
It is only common sense (to introduce another meaning of common) to hold that no contract exists in these circumstances. Though, if one party promises the other that the subject matter exists, that promise may be binding, and its breach give rise to a claim for damages.

Unfortunately, a case called Bell v. Lever Brothers [1932] AC 161 has left us with a doubt as to whether any other type of error could operate to make a contract void. The doubt is a small one, and for all practical purposes we can leave common mistake operative at common law to cases as obvious as the example given above.

There may be some equitable relief for other errors which do not make the contract void, because equity shares the same idea of mistake, but is a little more lenient in its application. The case of Cooper v. Phibbs (1867) 2 HL 149 gives us an example of the special working of equity to ‘put parties on terms’ in these circumstances. A will had been misconstrued to give ownership of a salmon fishery to A. A restored it, stocked it with fish, and leased it to B. It was then discovered that, under the true construction of the will, B (the lessee) had been the owner all the time. It is suggested that in this case mistake would have been operative at common law, but the parties went to equity. In those days, a case of this kind would have been heard before a separate court of equity because it turned on the meaning of a will. Equity and common law courts were completely separate systems at the time. Equity set aside the lease on terms that B repaid A some of the money expended on getting the fishery ready for leasing. Equity can still do this, although it no longer has a separate court system.

Note also that, just as in misrepresentation, mistake of law is not operative at all. But although a misconstruction of a will is a mistake of law, the case concerned a mistake of fact as soon as the will was applied to the relative positions of the parties.

5.4.2 Want of agreement. What is usually described as ‘mutual’ mistake is also a question of ineffective offer and acceptance; 3.2.1.

In such cases, equity has nothing to add. Either there is a contract or there is not, and in the absence of fraud or sharp practice, equity will not intervene. In Riverlate Properties v. Paul [1975] Ch 133, a lessor was not allowed to insert later a clause making the lessee liable for repairs, when he said he had left it out by mistake. Remember, rectification is only possible where it can be shown that both parties made the same mistake; 5.5.
5.4.3 If there is mutual incomprehension, then there will not be any fraud or sharp practice, and that brings us to the next category. This is conventionally known as unilateral mistake, which means that one party only has made a mistake, but a mistake of which the other knows or, on an objective test, ought to know. A recent example is found in *Wong Tak-sing v. Amertex International* [1988] HKLR 98.

Solicitors were negotiating a settlement. The claim was for more than $350,000, and the plaintiff’s solicitors wrote to the defendant’s solicitors offering to accept $25,000 in full and final settlement. It is clear that they had simply had trouble with their zeroes, but the defendant’s solicitors wrote back accepting immediately, and before there could be any correction made by the offerors. When the plaintiff’s solicitors pointed out their error, and said that $250,000 was intended, the reply was a cheque for $25,000 plus interest and a firm statement that a binding contract had been formed. The defendant asked for a stay of proceedings on the original action, on the grounds that there had been a settlement. The Court of Appeal ordered that the main action should go ahead, and the question of settlement be dealt with there. It is clear that they did not consider the exchange of letters made a contract. There had been operative unilateral mistake or, put another way, an attempt to accept an offer which the offeree knew the offeror never intended.

The difference from mutual mistake is merely that, instead of mutual incomprehension, we have manipulation of one party by another.

When should you plead unilateral mistake? In two cases.

1. When there has been no active misleading. No misrepresentation has been made, but I happen to know that you have made an error about what I am offering and I encourage that false belief without stepping over the line into misrepresentation. In such a case, there is no alternative action in misrepresentation, and the contract may be void only in the few cases where you can show that your error was as to the offer, rather than the worth of the subject matter. If your mistake is only as to the worth of the subject matter, there may still be an action for rescission, in the same way as you would proceed in misrepresentation; 5.3.3. However, remember, no damages. Let us try to illustrate this.

Ann owns an art gallery, and notices Benny looking around. Benny has paused in front of ‘Macau Scene’ and is saying to his
companion ‘An obvious Chinnery, undiscovered as yet, how very exciting.’ Ann, who knows that it is definitely not by the famous painter Chinnery, smiles and fades away, until Benny comes to seek her out. Then she carefully makes sure that she does not say anything misleading and, as luck would have it, Benny says nothing about the painter, probably because Benny thinks the price will go up if he talks too much about Chinnery.

There has been no misrepresentation. Benny could only prove the contract void if he showed that he thought the painting was being offered to him as a Chinnery — and in the circumstances this is improbable. Indeed, it would almost always require an active misrepresentation before this was possible. In the circumstances, equity may assist Benny and allow the contract to be set aside, since equity once again has a more generous notion of intervention than the law. But this is subject to the fact that equity’s bars may operate. On a practical level, it is hardly likely that Benny could prove that Ann knew of his mistake.

If Ann in these circumstances had actually said: ‘Yes, this is a Chinnery, of course’, then the possibilities widen. First we must decide whether it is a term of the contract that the painting should be by Chinnery. Even if not, Benny has an action in misrepresentation. This may bring him rescission, or damages; 5.2. So why go to mistake? It will be very difficult to establish its operation at common law, and equity at best will only bring rescission. We could have that for misrepresentation, and damages too.

2. Mistake only becomes crucial in facts such as these: a rogue gives a false name in negotiations to buy a car and is allowed to take the car away in exchange for a false cheque. He sells the car immediately to an innocent third party. The original owner then tries to get the car back from the innocent third party.

By now, it should be clear that an action in misrepresentation will certainly succeed, but rescission is impossible because of third party rights; 5.3.1(d). Damages for fraud are a certainty — if we can find the rogue and if he has any money.

If we go the mistake route, we will sue the innocent third party in the tort of conversion (in effect, saying ‘you are interfering with my better right to the car’). We will succeed if we prove a better right, and we will only prove a better right if we
establish that the original contract was void for mistake operative at common law. In our example, the mistake was as to the identity of the buyer. This is sometimes given a separate classification as ‘mistake of identity’, but is no more than an example of unilateral mistake.

To prove mistake of identity, we must prove that not only was there a mistake as to identity, known to the other party, but that reasonable steps were taken to check identity (in Hong Kong this must include an identity card check) and the identity of the person was of great importance. This last one is the greatest problem, in that usually it does not matter that the supposed person is creditworthy and the actual person unknown. It would have to be something more vital than that. After all, I do not usually care that my car goes to a good home, although with regard to a dog or cat that might be important. All I care about when I sell my car (unless I am unduly sentimental) is that I get my money.

The old lady owners of a car succeeded in proving operative mistake in *Ingram v. Little* [1961] 1 QB 31. It is said that they succeeded because they were at first unwilling to take a cheque at all. That is, they agreed to sell their car, but refused to take a cheque and allow the car to be taken away. However, their fears were set at rest when the buyer gave a name and a fine sounding address (on the equivalent of the Peak, one supposes). Having checked that such a person did live at such an address by looking up the name in the telephone directory, they allowed the car to be driven away in return for a cheque. The cheque proved worthless because the man who gave it was not the person who lived at that address. However, it seems their reason was merely a financial one, that is, they did not care who bought their car or who gave them a cheque — as long as he was creditworthy. This does not come within the criteria given in the previous paragraph and the decision of the English Court of Appeal is unlikely to be followed in Hong Kong.

The English Court of Appeal in *Lewis v. Averay* [1972] 1 QB 198, a case also concerning the sale of a car to a rogue claiming false identity (this time a film star), said that where persons are physically present it is almost impossible to establish mistake operative at common law. They distinguished *Ingram v. Little* as confined to its own particular facts, which
means that they did not admit it was wrong, but stated that it was unlikely to be followed in future.

So if we fail to establish common law mistake, we are left with equity. But mistake in equity will not make a contract void, and therefore it is no use in this situation. It would be better to sue for misrepresentation, since at least it allows us to claim damages. The damages are against the rogue, not the third party of course, and the rogue may be hard to find and even harder to get money from. However, there is at least the hope of a remedy here, whereas mistake in equity in this situation gives us none.

3. There is more chance of establishing mistake operative at common law when parties are corresponding and are not in each other’s physical presence. But be careful to differentiate between the case where someone pretends to be an established trader of whom the other has heard, and the case where a person merely boasts of assets he has not got. Only in the former is operative mistake possible and then it is a question of offer and acceptance; 3.3.5.

In *Cundy v. Lindsay* (1878) 3 App Cas 459, the rogue pretended to be the firm of Blenkiron & Co., by setting up in the same street, and signing his name (which happened to be Blenkarn) in such a way that it could be read as Blenkiron. The court was satisfied that Lindsay had only intended to contract with Blenkiron. They had sent an offer to Blenkiron & Co. only. Blenkarn knew that and could not accept it. But in *King’s Norton Metal v. Edridge, Merrett & Co.* (1897) 14 TLR 98, the rogue set up a back street company and gave it inflated letter heading — claiming depots which he did not possess all over the world. It was held that the deceived company did nevertheless intend to contract with the rogue’s company, making a mistake as to its worth and not as to its identity — once again a matter for equity, and once again with the problem of third party rights, since the rogue had sold goods obtained on credit.

So we see that to plead mistake is an admission of desperation. These days, most lawyers will advise a client: ‘If you have to rely on mistake, think again!’ However, signs of life have been seen in Hong Kong in an odd direction, in the area of written contracts affected by mistake.
5.4.4 **Non est factum.** This is an old remedy, known by this shortened form of a Latin phrase, meaning ‘not my deed’. It may apply when someone has signed a written document in circumstances where a third party has acquired rights, and thus misrepresentation will not help. In these circumstances, the person must prove two things: that the document is not what the signer thought it was, and that the signer was not negligent. The first requirement has been subject to argument — how different must it be? Different in class, or merely in effect? But the second in these days of increased literacy has proved the death knell of the defence in England. It is simply negligent to sign something you have not read. In *Saunders v. Anglia Building Society* [1971] AC 100, it was decided that it was negligent of an old lady to sign a document unread when she had mislaid her reading glasses, and the person persuading her to sign was known to her and trusted. Harsh indeed. For a time it looked as though *non est factum* could be relegated to the history books. However, in the case of *Gilman v. Ho So-wah* (1985) HCA 21277, the Hong Kong District Court found that a woman who ran a photocopy business was not defeated by negligence when she signed a document in English — a language she could not read. The judge held that she was so uneducated as not to be in the class of people reasonably required to take care. However, the case was odd in that no third party rights were involved, and the matter could presumably have been dealt with as a misrepresentation. But in the High Court in *Cheung Pik-wan v. Tong Sau-ping* [1986] HKLR 921, a woman who was illiterate and furthermore could not speak Cantonese was given relief even though third party rights were involved. Nevertheless, the court affirmed that the rules remained severe; it is necessary that the document bear no relation to what a person thinks she is signing, and that the plaintiff prove that she was deceived in circumstances where a person of reasonable intelligence would have been deceived. The District Court refused relief in the case of *Sun Hung-kai Credit Ltd. v. Szeto Yuk-mei* (1985) DCA 3549 because the signer did not even glance at the document, which was a guarantee. This was negligent indeed. However, the frequency of the defence of *non est factum* in Hong Kong shows that it is far from dead. It seems as though Hong Kong is reviving this old doctrine rather than go the way the English courts have and develop the doctrine of unconscionable bargain; 5.7. The plea must be treated with caution, however, because it defeats third party rights, being a form of common law mistake.
5.5  **Rectification**

The equitable remedy of rectification is available where a written agreement can be proved not to reflect the prior oral agreement. In this way the court rewrites the document to represent the true intention of the parties and can then give effect to it as rectified; 7.7.

5.6  **Duress and Undue Influence**

We have classed these two together, because undue influence appears to be merely the equitable version of common law duress.

5.6.1  *Duress.* This is a common law factor but it renders a contract voidable, showing the courts’ reluctance to upset third party rights. A party must prove that the contract was induced by violence or unlawful restraint, or threats thereof, to the contracting party or a member of that person’s family. In *Barton v. Armstrong* [1976] AC 104, Armstrong threatened to kill Barton unless he signed a contract. The Privy Council said that made the contract voidable.

5.6.2  *Economic duress.* Recently a new form of duress, economic duress, has been developed in a number of cases in which one party has been coerced into an unfavourable renegotiation of a contract. In these cases, there has been consideration for the change, but it has been against the will of that party. For example, in *North Ocean Shipping v. Hyundai Construction: The Atlantic Baron* [1979] QB 705, the builders of a ship were to be paid in US dollars. At the time the dollar was dropping, they told the buyers that unless they increased the payment by 10%, there would be no delivery on the due date. The builders knew that the buyers had many commitments and needed the ship. The court was satisfied that there was economic duress. The renegotiation was prompted by coercion by the builders, who twisted circumstances under their power. This is why most cases have so far been about renegotiations — because there it is clear that it is not merely market forces which are involved. As it happens, the buyers still lost their case. They paid a final instalment after delivery, and this was held to be affirmation after duress had ceased. It seems that whatever kind of duress it is, one must act swiftly once pressure is removed, or lose any remedy. According to
Atlas Express v. Kafco [1989] 1 All ER 641, one factor in deciding whether there is duress is the existence of possible alternatives and how far they have been considered. When Atlas refused to continue as carriers without an increase in the contract price, the court was satisfied that no alternative form of transport was practicable. But in Williams v. Roffey (3.7.6.3) it was clear that several alternatives existed, and had been considered, before the promise of extra pay was made. It seems that the doctrine of economic duress is now well established and likely to expand.

5.6.3 **Undue Influence.** A party can avoid a contract into which he or she has been coerced by undue influence. Under this equitable heading are cases where threats are made of lawful imprisonment of a family member. In Williams v. Bayley (1866) 1 HL 200, the son had been forging his father’s signature to certain notes. The bank told the father to agree to honour these notes (one need not honour a forgery). If he did not, they would prosecute the son, and he would be severely punished. The father did as he was told, because he had no choice. That case has always been regarded as something of a museum piece, but a recent case in Hong Kong has remarkably similar facts. In Diner’s Club International v. Ng Chi-sing (1985) CA No. 153, the credit card company put improper pressure on a father to guarantee his son’s credit card debts, threatening that the son would be reported to the Commercial Crimes Bureau. Diner’s Club had used undue influence and the guarantee was voidable.

These cases show the easiest way to prove that one had no choice, for the threats to a child’s well-being are enough to curtail any parent’s freedom of choice. In other cases it is more difficult to prove that influence was such that free choice could not be exercised.

Thus we find undue influence most usually in the case of fiduciary relationships. These are relationships where a weaker party relies on the knowledge and advice of a stronger party. It is therefore easy for the stronger party to influence the mind of the weaker. Where transactions take place between those parties, undue influence is presumed unless disproved by the stronger party. For example if I, as a solicitor, buy a flat from a client of mine, the presumption will arise. I can best rebut it by sending my client to another solicitor for advice on this transaction — hoping that she will choose to return to me in future!
The relationships include solicitor and client, doctor and patient, trustee and beneficiary. They do not include other professional relationships automatically. Parent and child is a fiduciary relationship with the parent always presumed to be the stronger party. The child is never presumed to be stronger. It arises at birth and does not necessarily end with the child’s majority or marriage. It ends when it can be shown that the child is ‘emancipated’ from the parent. This point was made in *Lancashire Loans v. Black* [1934] 1 KB 380, where a woman of full age, married and living away from home, was held to be still in such relationship with her mother. Religious adviser and disciple is another such relationship. There is no fiduciary relationship in marriage, however.

Because undue influence is hard to prove, a third category has arisen. In this category, a relationship not normally fiduciary is proved in the case of these particular parties to be so. Then the presumption of undue influence arises and must be disproved by the stronger party. Cases have included engaged couples, housekeeper and elderly employer, and, of most importance recently, banks and customers, and pop stars and their managers.

The relationship of bank and customer is at bottom simply a relationship of debtor and creditor. Nevertheless, it does have some fiduciary features; *Cheques* 3.1. For it to be a fiduciary relationship in every respect would cause problems and undermine the freedom of the bank to deal with customers’ deposits with a free hand. However, traditionally the bank has been a source of financial advice, particularly in country areas. In such cases the bank has come to be in fiduciary relationship to a particular customer. This was decided clearly in the case *Lloyds Bank v. Bundy* [1974] 3 All ER 757. Once again, we have the case of a father who dotes on a profligate son. In this case old Mr Bundy had mortgaged his farm to the limit and beyond for the sake of his son’s doubtful business ventures. A new bank manager, tidying up the accounts no doubt, came to visit him with further forms to sign. Mr Bundy, being accustomed to rely on the bank manager, signed and in consequence found the bank about to repossess his farm. The court held that a fiduciary relationship existed, and the document could be set aside. The change of manager did not matter — it was a relationship with the bank and not the individual.

For a while banks were worried in case fiduciary relationships became the norm. However, the House of Lords in *National West-
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*minster Bank v. Morgan* [1985] 1 All ER 821 set the matter in perspective. They stated that although the *Lloyds Bank* case was correctly decided on its facts, it took a long time to set up such a relationship. In the instant case, the relationship could not be proved, since the relationship had scarcely lasted five minutes! It concerned a wife with a profligate husband. His business was failing, and the building society was about to repossess the house. In England most mortgage loans are made by building societies rather than banks. The bank had agreed to a bridging loan, whereby it would pay off the building society but, as the house was in joint names, the wife’s signature was needed. She alleged a fiduciary relationship but, since she had never been a customer of the bank (it was her husband’s bank), there had been no time for it to grow. Neither could she prove undue influence. She failed the first test; she could not prove that the transaction was manifestly disadvantageous to her. If she had not signed, she and her husband would have lost the house to the building society even earlier.

If you are interested in the pop musician cases, you can read *O’Sullivan v. Management Agency and Music Ltd.* [1985] 3 All ER 351. This is fertile ground, with raw young talent being shaped by hard-headed business people who probably have to reckon on 99 singers doomed to oblivion before they discover one successful Gilbert O’Sullivan. Here they admitted they gave O’Sullivan no access to outside advice on his contract — because, if they had, they knew he would have been advised not to sign!

### 5.7 Unconscionable Bargains

This is the mystery factor. Hidden for years in footnotes, as an interesting historical point related to bargains with heirs to ‘catch’ their inheritances at a later date, it has come to the fore in recent cases in England. It is an equitable development to assist those who have been victimized by a stronger party in cases which do not fall within the undue influence rules. It remains a rather nebulous area, and its relationship with the common law doctrine of economic duress is uncertain. So far, it has not found favour in Hong Kong. It should be noted that mere imbalance of power is not enough. The Privy Council said in *Hart v. O’Connor* [1985] 3 WLR 214:
Equity will relieve a party from a contract which he has been induced to make as a result of victimization. Equity will not relieve a party from a contract on the ground only that there is contractual imbalance not amounting to unconscionable dealing.

It may assist in future in decisions such as *Gilman v. Ho So-wah* (5.4.4), but, being an equitable doctrine, will not overcome third party rights.

**Points to Note**

1. Vitiating factors or flaws in the contract may have two effects: they may make the contract voidable or, more rarely, void.

2. Ownership passes under a voidable contract but not if the contract is void.

3. Innocent third parties may suffer if a contract is declared void.

4. Equity will never declare a contract void or set it aside unless it can do so without harming innocent third parties.

5. A misrepresentation is an untrue statement of fact, made by one contracting party to the other, which was intended to (and did) induce the other party to enter into the contract.

6. The untrue statement may be made orally, in writing or by conduct or any mixture of those methods.

7. Silence, or a half-truth, or a statement originally true which becomes false by the time of the contract may constitute misrepresentation.

8. Silence can be the equivalent of misrepresentation if the contract is *uberrimae fidei*.

9. A statement of law is not a statement of fact.
10. A statement of opinion or intention is not a statement of fact.

11. It is sufficient if the misrepresentation is a partial inducement.

12. A misrepresentation is fraudulent if it is made with knowledge of its falseness or recklessly, not caring whether it is true or false (Figure 2).

\[ \text{DAMAGES FOR MISREPRESENTATION} \]
\[ \begin{align*}
\text{FRAUDULENT} & \quad \text{NON-FRAUDULENT} \\
\text{In the tort of DECEIT and} & \quad \text{NEGLIGENT} \quad \text{WHOLLY INNOCENT}
\text{Under s3(1)} & \quad \text{In the tort of}
\text{NEGLIGENCE} \quad \text{Under s3(2)}
\text{and} & \quad \text{under s3(1)}
\text{under s3(2)}
\end{align*} \]

\text{Figure 2}

13. If the misrepresentation is fraudulent, damages may be recovered in tort.

14. Rescission is an equitable remedy for any kind of misrepresentation.

15. Rescission will not be granted if:
    (a) the party to whom it was made has shown an intention to continue with the contract;
    (b) that party delays;
    (c) restoration is impossible;
    (d) a third party has acquired rights.

16. The party injured by an innocent misrepresentation may recover an indemnity but not damages in equity (but note legislative exceptions).
17. Misrepresentation Ordinance allows damages for misrepresentation:
   (a) under s3(1) if the misrepresentor cannot prove an honest belief in
       the truth of the representation, and reasonable grounds for that
       belief;
   (b) under s3(2) in lieu of rescission.

18. An action may arise in the tort of negligence for a negligent representa-
    tion causing physical, or in some circumstances financial, loss.

19. Mistake at common law makes the contract void; in equity voidable.

20. If both parties base the contract on their belief in the existence of
    subject-matter which later is shown to have been non-existent at the
    time of the contract, the contract is void at common law for mistake.

21. In such a case, equity would set the contract aside only on terms.

22. Mistake of fact may affect validity, mistake of law will not.

23. Mutual mistake is lack of agreement.

24. Unilateral mistake arises where one party knows of the other’s mistake.
    It is also a lack of agreement. One party cannot accept an offer in a
    sense which it knows the other did not intend.

25. Mistake is pleaded when it is essential to prove a contract void to stop
    the passing of ownership.

26. Non est factum is a defence only if it can be proved that the document
    was not what the signer thought it was and that the signer has not been
    negligent. Then the contract is void at common law.

27. Rectification corrects a written agreement to represent what can be
    proved to be the intention of both parties when they made the contract.

28. Duress is violence or threats which force a party to contract against its
    will. It renders the contract voidable at common law.

29. Economic duress is improper coercion of a financial kind which has the
    same effect as duress.
30. Undue influence renders a contract voidable in equity. Such influence has to be proved unless between the parties there exists a relationship which reverses the burden of proof, such as solicitor and client, parent and child.

31. Equity will in some circumstances relieve a party who has made a contract as a result of the other’s victimization, if that amounts to an unconscionable bargain.
Chapter 6

Discharge

6.1 Methods of Discharge

A contract may be discharged in any of four ways, by performance, by agreement, by one party accepting the other’s breach as repudiation, and by frustration.

6.2 Performance

The contract ends naturally when both parties have done what they contracted to do. If Ann fully performs her part of the contract but Benny does not, Ann is discharged and has a right of action against Benny for breach. It is therefore necessary to find out what ‘fully performs’ means. The general rule is that both parties must do precisely what they promised to do. If Benny fails to perform fully he is guilty of a breach of contract and has no rights against Ann at all. He cannot sue under the contract because he has not performed his part; the right to sue depends upon either complete performance, or, if the other party is in breach, a willingness to perform if the other party will. If Benny has only partly performed his obligations, he cannot sue for a fair price for the work he has done under the contract. He will not be heard to say that he has done something for Ann which has brought a benefit to Ann and that he is therefore entitled to some remuneration. This would be to go against the terms of the contract, which speak of doing a complete job for a certain price. A claim for a fair price for a part of the work, which is called by the technical name of a claim on a quantum meruit (‘as much as he has earned’), is not based on the terms of any contract, and must therefore depend upon an implied promise of the other party to pay. There can be no such promise implied where there is an express contract covering the same subject-matter, but stipulating complete performance. An implied term must give way to an express term
(4.10). In *Sumpter v. Hedges* [1898] 1 QB 673, A agreed to build two houses for B on B’s land for £565. He did part of the work, to the value of £333, and then abandoned the job. B had the buildings finished incorporating the work that A had done. A sued B for £333 but failed. The Court of Appeal held that he could recover nothing at all. Collins, L.J. said:

> Where, as in the case of work done on land, the circumstances are such as to give the defendant no option whether he will take the benefit of the work or not, then one must look to other facts than the mere taking the benefit in order to ground the inference of a new contract . . . The mere fact that a defendant is in possession of what he cannot help keeping, or even had done work upon, affords no ground for such an inference.

There are exceptions to the rule that performance must be precise. They are all based on the presumed intention of the parties.

6.2.1 *Substantial performance.* If the difference between the work actually done and that undertaken to be done is very slight, the party who has committed this slight breach may be allowed to recover the contract price less an allowance for the difference between that substantial performance and the performance required to meet the contractual requirements. The difference between substantial performance in this sense and complete performance is a breach of warranty. The damages for this breach of warranty will equal the value of the difference. The difference between the remedy for a breach of warranty and a breach of condition is an illustration of the difference between substantial performance and insufficient performance. The injured party must be content, where there is substantial performance (or breach of warranty), with damages, or a reduction of the price; but, where there is a breach of condition (or no sufficient performance), may repudiate the contract.

6.2.2 *Divisible contracts.* If a contract is considered by the court to be divisible, a party can recover part of the price for performing part of the consideration. But there is a presumption against a contract being divisible. The party wishing to recover something in exchange for performing only part of the contractual responsibilities must
prove that that was intended by both parties when the contract was made. Such evidence may be provided by showing that it was intended that payment should be made by instalments as the work progressed, as is usual in building contracts.

6.2.3 Where performance is prevented by the other party. Where Ann is prepared to perform her part of the contract but is prevented from doing so by the other party, Benny, then Ann may sue Benny for damages for breach of contract, or may repudiate the contract, or do both.

6.2.4 Where the partial performance is accepted. If Ann accepts the partial performance in such a way as to imply a promise to pay for it, then she must pay for the work done even though it is no performance of the original contract. This is a question of variation of contract. Benny must prove that Ann had an effective option of refusing the partial performance. In cases like Sumpter v. Hedges, this is clearly not so. But a party who can prove such an agreement to vary the contract can sue on a quantum meruit. Where a seller delivers less than the contract quantity of goods, the buyer can either reject them altogether or accept the reduced amount at the contract rate; SOGO s32.

6.2.5 Where there is frustration. Where the contract has been frustrated, the Law Amendment and Reform (Consolidation) Ordinance (Cap 23) may apply, in which case its provisions deal with the amount which can be claimed for partial performance; 6.5.

6.2.6 Tender. In this context of performance it is important to note the effects of tender of payment and tender of performance. There is an ambiguity to be cleared up first. The word ‘tender’, used in the context of an attempted payment or performance, must be distinguished from the same word used in the context of offer and acceptance; 3.6. There it describes the replies received by an advertiser who has asked contractors or suppliers to submit offers to do work or supply goods. Here in the context of performance, tender is a rejected attempt to perform or pay. Tender of payment has different consequences from the tender of other kinds of performance and must be treated separately. If the promise, performance of which is tendered, is other than to pay money, such as the tender of delivery
of goods or the tender of services, then refusal of the tender by the
other party discharges the contractual obligation of which perform-
ance was tendered. A supplier, who has contracted to sell and
deliver goods, needs to attempt delivery only once in a reasonable
fashion. If the buyer refuses to accept the goods, then the seller has
the immediate right to sue for damages for breach.

If the promise is to pay money, however, a refusal to accept
payment does not discharge the debtor’s liability to pay. The effect
of the refusal is to make it unnecessary for the debtor to tender the
money again. The general rule, in default of agreement to the con-
trary, is that the debtor must seek out and pay the creditor when the
debt is due. But a debtor who has once made a proper tender, which
is refused, need make no further attempt to pay. The debtor can wait
until the creditor sues and then pay the amount of the debt into court.
The creditor will recover no costs of the action. For a tender of
payment to be valid, the exact amount of money due must be
tendered. There will be a good tender if more than the amount is
tendered as long as the creditor does not require change. The money
offered must be legal tender, that is current coins of the realm or
bank notes. Coins of less than $1 are legal tender for payment of any
amount of $2 or less. Coins of $1 and upwards are legal tender for
any amount up to $100. Bank notes of any denomination are legal
tender for any amount. If there is a prior agreement to accept a
cheque, then the tender of a cheque drawn for the right amount is a
proper tender.

6.3 Agreement

A contract can be varied or discharged by agreement, oral or writ-
ten, or by deed. The contract can be discharged or varied orally even
though it was made in writing or even by deed. If the discharging or
varying agreement is made by deed there is no need to show consid-
eration has been given. Otherwise consideration is as necessary for
such an agreement as for any other, except that in this situation the
doctrine of equitable estoppel may be relevant; 3.7.6.

Even if the contract which is to be varied is one which is
required by the Conveyancing and Property Ordinance (Cap 219) s4
(11.2) to be evidenced in writing, that is even though it is a contract
for the sale or other disposition of an interest in land, it may be
discharged orally, though it cannot be varied by a contract which is not itself evidenced in writing. Any variation is a replacement of the old agreement by a new agreement which itself is caught by that section, and must be evidenced in writing. But the principle of equitable estoppel is just as apt to cure the lack of writing in a variation as it is to cure the lack of consideration; 11.2.

If Ann and Benny make a contract for the sale of an interest in land, and Ann tells Benny that she will not enforce part or all of her contractual rights, she will not later be allowed to enforce those contractual rights in breach of that promise. She cannot argue that because the variation is not evidenced in writing it is therefore ineffectual. The elements of the principle of promissory estoppel set out in *Ajayi v. Briscoe* [1964] 1 WLR 1326 are relevant here also. If Benny can prove that the requirements of the test in that case are complied with, he will be able to resist an action brought against him on the original contract.

### 6.4 Accord and Satisfaction

If Ann owes Benny $50 under some contract, and they agree that Ann should instead give Benny a camera, then Ann’s debt is discharged by the new agreement, which replaces it. This process is called accord and satisfaction. The agreement to substitute a new consideration is the accord, and the new consideration so substituted is the satisfaction. The problem of whether there has been a true accord and satisfaction sometimes arises where the satisfaction in question is a promise, perhaps to accept less than the original debt.

The parties may have provided in their contract for its discharge. Such prior agreement is common, and it is necessary where it is intended that one party should be given the power to terminate the contract whether the other party likes it or not. This situation arises in contracts of employment, which usually provide that either party may bring the contract to an end by giving the other party notice.

### 6.5 Acceptance of Breach as Repudiation

Breaches of contract may be of three kinds: failure to perform,
repudiation, or self-imposed inability to perform. The commonest kind of breach is the failure to perform what the contract requires, for example by late delivery or payment, or by inferior workmanship or faulty goods. Repudiation takes place where a party expressly or impliedly refuses to carry out duties under the contract. Parties may also make it impossible for themselves to carry out the contract. If Ann has contracted to sell goods to Benny and then sells those goods to Charles, she has made it impossible for herself to carry out her contract with Benny. This is a kind of repudiation.

If there is one rule of the law of contract which can be stated confidently and without qualification, it is that a breach of contract entitles the injured party to damages. If the breach is so serious that it shows an intention to be no longer bound, or breaks a term so important that the foundation of the contract is destroyed, the other party may also treat the contract as repudiated. The repudiation may take place before the time when performance is due. In such a case, the breach which repudiates the contract is called ‘anticipatory breach’. Because a party cannot bring a contract to an end by breaking it, however fundamental the breach, unless the other party accepts that breach as repudiation, the injured party has a choice. When a breach is committed before the contract date of performance, it may be sufficiently serious to allow the injured party to treat it as repudiation. If it is bad enough to be treated as repudiation, the injured party may either treat the contract at once as discharged and sue for damages (and possibly some other remedy), or leave the contract in existence until the contract date for performance. If the injured party chooses to wait, the party in breach may carry out its part of the contract at any time until the contract date or the other’s acceptance of the repudiation. Moreover, if something happens in the meantime which relieves the party in breach of liability to perform the contract, then the party in breach is able to take advantage of this luck and need pay no damages.

In *Avery v. Bowden* (1855) 119 ER 647, A agreed to charter B’s ship at Odessa and to load a cargo of wheat there within 45 days. A found that he could not get hold of a cargo and told B that he would have to break the contract. Nevertheless B kept the ship at Odessa, hoping that A would be able to get some wheat, and would then perform his contract. But before the 45 days were up, that is before the contract was due to be performed, the Crimean War broke out, and the contract between A and B became illegal. A was therefore
discharged of his obligation. It was then too late for B to sue for anticipatory breach.

6.5.1 **Conditions, warranties and fundamental breach.** Whether a breach of contract will allow the injured party to treat the contract as at an end will depend on whether it is a repudiation. The tests by which terms are classified were set out in 4.9. If the term broken is a condition, the breach is a repudiation. If the term broken is a warranty, the breach is not a repudiation. Of course, a complete failure to perform, such as delivering a bicycle when the contract calls for a car — sometimes called fundamental breach — is also a repudiation.

6.5.2 **The injured party cannot be compelled to accept the repudiation.** Unless the breach makes further performance of the contract impossible for the injured party, the injured party cannot be forced to accept the breach as repudiation but can go on performing the contract. In *White and Carter v. McGregor* [1962] AC 413, McGregor agreed with White that White should advertise McGregor’s business on a certain number of public rubbish bins for three years. On the very day of that agreement McGregor changed his mind and tried to repudiate the contract by making it clear he had no intention of paying. Nevertheless White performed the contract for the next three years and then sued McGregor for the agreed price and won in the House of Lords. Note that this was a claim for the price, not for damages; 7.6.

6.6 **Frustration**

6.6.1 **The basis of frustration.** It used to be said that there was a general rule that the parties to a contract were liable in damages for non-performance of the contract, even if performance had become impossible or futile, unless they had inserted in the contract clauses exempting them from performance in such circumstances. But there have been exceptions to this rule for such a long time that no such broad rule can be stated. The courts recognize that circumstances may so change that the contract ceases to bind the parties. The history of this relief, the doctrine of frustration, shows that the limitations on the old general rule grew up as isolated exceptions,
dealing with the situations where the subject-matter of the contract was destroyed, or performance became illegal, or a party fell ill, and so on. But since the decision of the House of Lords in *Davis v. Fareham* [1956] AC 696, it has been possible to see a general principle which applies to all kinds of contractual situations. In that case it was said:

Frustration occurs whenever the law recognizes that without fault of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract.

The principle of frustration became of great commercial importance when the Suez Canal was blocked during the Suez Crisis at the end of 1956. Many charterparties in existence at that time had been entered into on the assumption that the ship would sail by the Suez route. In one of the cases which arose out of this situation, *The Eugenia* [1964] 2 QB 226, a workable test was propounded by Lord Denning in the Court of Appeal, based on the decision in *Davis v. Fareham*, which has since found favour in other cases. In *The Eugenia*, A, the shipowner, had chartered the ‘Eugenia’ to B for a voyage out to India from Genoa via the Black Sea. It was clear that both parties assumed that the voyage would be via the Suez Canal. When B found that the Canal had been blocked and he would have to travel via the Cape of Good Hope, he wanted to avoid the charterparty, and said that it had been frustrated by the closure of the Canal. Lord Denning in the Court of Appeal said:

If it should happen, in the course of carrying out a contract, that a fundamentally different situation arises for which the parties made no provision — so much so that it would not be just in the new situation to hold them bound to its terms — then the contract is at an end.

In holding that the charterparty had not been frustrated, he stated a test to be applied whenever a party pleaded that a contract was no longer binding because it had been frustrated.

First, it is necessary to construe the terms which are in the
Discharge

contract, read in the light of the contract’s nature and the relevant surrounding circumstances when the contract was made. This part of the test reveals the scope of the original obligation, that is what the parties would have to do to carry out the contractual promises in the original circumstances contemplated by the parties.

Secondly, it is necessary to examine the situation existing after the event, which is alleged to frustrate the contract, has occurred, to find out what the obligation of the parties would now be if the words of the contract were literally enforced in the new circumstances.

Thirdly, a comparison must be made between the original obligation and the new obligation, to decide whether the new is radically or significantly different from the original obligation, to such an extent that it would be unjust to hold the parties to the original obligation.

6.6.2 Frustration cannot be self-induced. Obviously a party cannot plead that the contract has been frustrated where it was possible to avoid the frustrating event. In Maritime National Fish v. Ocean Trawlers [1935] AC 524, A owned a trawler and chartered it to B, for the purpose of fishing as both A and B knew. Both knew that it could not be used for fishing unless it was fitted with an otter trawl and that it was an offence to use such a trawl without a licence. B had four other boats he used for fishing, and he applied for five licences. He was granted only three, so he designated three of his own fishing boats as recipients of the licences. He then said that he need not abide by the charterparty as it was frustrated because the boat could not be used for fishing. He refused to pay the hire. The Privy Council held that there was no frustration. B caused the impossibility, or at least he could have avoided it by allotting the licence to the chartered trawler.

6.6.3 Leases. Because a lease creates an interest in land, the law treats it as something more than a contract. Nevertheless, the House of Lords has held that a lease can in law be frustrated, though that is unlikely ever to happen in fact. In National Carriers v. Panalpina [1981] 1 All ER 161, enjoyment of leased industrial premises was greatly reduced because access to them was severely restricted for a lengthy period but the contract of lease was not frustrated. In Wong Lai-ying v. Chinachem [1979] HKLR 1, the respondents were selling individual flats in University Heights to each of the appellants
by 75 year leases in blocks yet to be built. A major landslide destroyed work in progress and building could not be restarted for 3 years. But the value of the flats rose greatly. The respondents refused to go ahead with the sales, alleging frustration; the appellants alleged the contract still existed. The Privy Council held that the landslide was a frustrating event. All the courts were concerned only with the construction of one clause; did it provide against the events which had occurred? On the facts, it did not, and all the contracts were frustrated because resumption of building when land prices had risen was a totally different undertaking.

6.6.4 Consequences of frustration. At common law the loss lay where it fell, unless there was a total failure of consideration, when any money paid or property transferred was recoverable. This was changed by Law Amendment and Reform (Consolidation) Ordinance (Cap 23) ss16 to 18, which provide:

(i) Money paid before the frustrating event is recoverable.
(ii) Money payable before the frustrating event ceases to be payable.
(iii) If the party to whom the money was so paid or payable has incurred expenses before the frustrating event occurred, in performance of the contract, the court may, if it considers it is just having regard to all the circumstances of the case, allow that party to retain (or recover) the whole or part of the money paid or payable, not exceeding the amount of the expenses. Such expenses can be recovered only if there is a sum paid or payable under the contract already at the time of the frustrating event.
(iv) A party who has received a valuable benefit under the contract before the frustrating event can be ordered to pay to the other party whatever the court thinks just, not exceeding that benefit.

By s17 certain contracts are excluded: most charterparties and contracts of carriage of goods by sea; most contracts of insurance; most contracts governed by SOGO s9, which provides that contracts for specific goods are frustrated if the goods perish before the risk
passes to the buyer, unless the parties have agreed otherwise.

The parties can always exclude the operation of ss16 to 18 if they so provide. The Court will never take into consideration the fact that a party has insured against the risk of the frustrating event.

**Points to Note**

1. A contract may be discharged by performance, agreement, frustration, or acceptance of breach as repudiation.

2. The contract ends when both parties have performed what the contract requires.

3. Partial performance need not be accepted or paid for unless the contract so allows.

4. If partial performance is accepted it must be paid for *pro rata*, unless the contract provides otherwise.

5. If the failure in performance is slight, the contract price may become payable with an allowance, unless the contract shows a different intention.

6. If the contract is divisible, that means part payment may be recovered for partial performance.

7. Tender of performance discharges the obligation to perform.

8. Tender of payment does not discharge liability but the debtor is relieved of the obligation of further tender.

9. A contract can be discharged (or varied) by oral or written agreement or by deed.

10. Consideration is required to support an agreement to discharge, unless a deed is used.

11. A contract required to be evidenced by writing can be discharged (but not varied) orally.
12. An agreement to substitute a new consideration is called an accord, the new consideration itself satisfaction.

13. Breach may be failure to perform, or repudiation, or self-imposed inability.


15. Breach does not discharge the contract. If it equals repudiation, the innocent party may elect to accept it as discharge or not.

16. Whether a breach equals repudiation depends on the importance of the term broken (condition not warranty) or the nature of the breach.

17. A party may continue performance and sue for the price, but must mitigate damages.

18. A contract will be frustrated whenever the law recognizes that without the fault of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract.

19. Note carefully the elements of the Eugenia test.

20. Frustration cannot be pleaded if the impossibility is self-induced.

21. A lease may be frustrated, if the test set out in The Eugenia is satisfied.

22. Note the provisions of Law Amendment and Reform (Consolidation) Ordinance (Cap 23) which deal with some of the effects of frustration.
Chapter 7

Remedies

7.1 The Range of Remedies

The last chapter was concerned with how a contract comes to an end. Most contracts are performed — they come to a natural conclusion. But some are broken, or a party believes that they are. What can that injured party do? There are many possible responses to a breach but the most important thing to remember is that a contract is an agreement that the state recognizes as legally binding. If a party to a contract can prove to the court that the other party has broken it, then the court must always recognize the injured party’s right by awarding damages unless the injured party has lost that right by waiting too long. Though damages are an ever present remedy, however, they may not be the most appropriate one. Instead, the injured party may prefer to do nothing; or to negotiate a solution with the other party, whom lawyers call ‘the party in breach’; or to seek help from a mediator; or to go to arbitration; or to use some kind of self-help; or to choose a different remedy altogether which the law offers: an action in debt or for the price; an action in tort for fraud or negligence; an action in quasi-contract; or one of the remedies provided by equity, of which there is quite a range. First, there are those remedies which do not require the intervention of the courts.

7.1.1 Putting up with the breach. It is very common for a party who has suffered a breach of contract to do nothing about it. That may be because the breach is trivial — the car is not quite the shade of bronze which was ordered. Or it may be that the injured party accepts the excuse of the party in breach, or realizes that a lawyer would cost more than the breach is worth. The parties may be old friends or relatives. The injured party may make handsome and regular profits from doing business with the party in breach and not want to lose the business, which would be a likely result of any
attempt to recover any remedy for the breach. The injured party may fear that even a successful action in the courts would bring bad publicity, or some other damage to reputation or credit-rating. Perhaps the injured party’s lawyer may advise, having attempted to recover some recompense for the breach, that whatever its merits the injured party’s case has too low a chance of success to make an action worthwhile.

7.1.2 Negotiating a remedy. In most everyday contracts by which we buy goods, if we consider ourselves badly done to, we take them back. When you study the law relating to sales of goods, you will find that it is unusual for SOGO to provide a disappointed buyer with the right to take goods back and that you never have a right to insist that they are repaired or replaced. The usual remedy is damages. Yet if you bought a packet of biscuits which were all soft, you would not expect damages; you would expect — and probably be offered — a replacement. If you bought an amplifier and it failed to work after a week, you would not expect damages but a replacement or, if the fault was minor, a free repair. Whatever the written terms of the contract or guarantee, whatever SOGO says, you and the dealer would in most cases come to some arrangement — negotiated by the two of you — which would solve the problem.

Of course the terms of the contract may make a big difference. They certainly will if you get nowhere with the dealer and take the matter to your solicitor. Then it is important not only that the law is clearly stated by SOGO and the cases decided on it, but also that the terms of your contract with the dealer are also clear and in your favour. The clearer the law — both that made by the state and that made by the parties — the better the chance of a negotiated solution. The advantage that lawyers have over the parties themselves is, of course, not only that they are more dispassionate but also that they are experts in negotiation. They know how to bring pressure through legal procedures and they can calculate the odds in favour of settlement accurately from their experience of negotiation, and judge the chances of success in litigation from their knowledge of the law and of the kind of evidence which is likely to satisfy the court.

7.1.3 Mediation or conciliation. If the parties cannot agree about the breach, they may seek help from a third person, not each going to their own lawyers but both finding one person, acceptable to both,
whose task it is to help them to agree, for instance by acting as go-between. Such a process is called mediation, or in some contexts conciliation. The mediator is given no power to decide the dispute, just to assist in finding a settlement. Mediation procedures are found in some employment contracts and sometimes in international contracts, particularly with state agencies in socialist countries.

7.1.4 Arbitration. A contract is an agreement which the state recognizes as legally binding. If the parties say in their contract that it is not subject to the courts, then either there is no contract at all or the part that tries to deprive the courts of jurisdiction will be ignored. Lawyers say that such an agreement tries to 'oust' the jurisdiction of the courts. But since the matter was settled in England in Scott v. Avery (1856) 5 HLC 811, the parties have been allowed to insert in their contract an arbitration clause. Arbitration is now governed by legislation allowing the parties to substitute arbitration for court action and is actively encouraged by the Government in Hong Kong. If the contract contains an arbitration clause — and nearly all building contracts and insurance policies, for example, do — then a party who seeks a remedy must bring the dispute before the arbitrator appointed by the contract. Neither party can bring an action in the courts. The arbitration clause will say how the arbitrator is to be chosen. Sometimes each side may nominate an arbitrator. If those arbitrators disagree, a third person, called on umpire, decides.

The advantages of arbitration are that the hearing takes place in private; that an arbitrator may be appointed who is more expert in the subject matter, for example, building or accounts or ships, than a judge is likely to be; and that procedures may be less formal and legalistic. It can no longer be said that arbitration costs less than litigation or is swifter, at least not in Hong Kong now.

7.1.5 Self-help. The law may allow a party to resort to self-help if the other party breaks the contract. If you have ordered goods but not paid for them, and when they are delivered they do not comply with the contract description, you can reject them and refuse to pay if the difference amounts to a breach of condition; SOGO s13(2). If you have contracted to sell goods and when you attempt to deliver the buyer refuses to pay the price, you can refuse to deliver; SOGO s42. If the goods are in transit, you can stop them when you discover the buyer is insolvent; SOGO s46. If you are half way through painting
a shop and the owner makes it clear she will not pay you for the job, it would usually be foolish to continue and the law allows you to discontinue performance of your contractual obligations on the ground that she has repudiated the contract; 6.5. If you have signed a contract to sell your flat and have wisely taken a deposit, you can hold on to it when the purchaser refuses to complete. Some forms of contract regularly give similar rights. A lease may allow the landlord to forfeit the lease, retain a deposit and eject a tenant who fails to pay the rent. A hire purchase or hire agreement may allow the owner to repossess the goods if the hirer fails to pay an instalment.

Whether an injured party may treat the other’s breach as repudiation is dealt with at 6.5. If the court finds that the other party’s breach did not amount to repudiation or that in some other way the act of self-help was itself a breach of contract, then that act will give the other party a right to damages.

Self-help is for that reason always risky. If it involves invading the premises of the party in breach, or removing property, or even more obviously any kind of violence, it may be a criminal offence. Any kind of trespass, that is a wrongful act against the other’s person, goods or land, will give rise to an action for damages in tort.

7.2 An Action in Debt or for the Price

If the injured party decides to seek the assistance of the courts, there is a range of possible remedies; in debt, for damages in contract or tort, or another common law or equitable remedy.

If the breach is non-payment of a debt, the injured party may either sue for damages or for the amount of the debt. If a loan is not repaid when due or rent is overdue, the normal action is in debt, or in modern terminology ‘liquidated damages’, where ‘liquidated’ means ‘fixed’. The amount must be a sum of money fixed by the contract. If the contract is for the sale of goods and the price is not paid when it becomes due, the seller may bring an action for the whole price rather than for damages; SOGO s51.

An action for a fixed sum, whether in debt, or for the price or for any other agreed sum, is fundamentally different from an action for damages, which are called general damages when distinguished from liquidated damages. A party who sues in debt or for the price or for any other sum fixed by the contract itself merely proves non-payment; there is no need to show any actual loss or damage.
7.3 Damages

Every breach of contract gives rise to a right of action for damages. A contract is an agreement which the courts recognize as legally binding. The way they show that recognition is by granting damages for any breach.

7.3.1 Nominal damages. Even if the injured party cannot prove that it has suffered any loss, the court must make an award of damages, though in such a case they will be nominal, for example one dollar. In *C and P Haulage v. Middleton* [1983] 3 All ER 94, the defendant, the local council, had granted a contractual licence to the plaintiff, a car mechanic, of premises on which he could carry on his trade. The defendant broke the contract by ejecting him ten weeks before the end of the contract period. The defendant tried to help by allowing the plaintiff to carry on his work at home, which they could and would normally have forbidden. So the plaintiff saved the rent of the premises. He could not show that the defendants’ breach had caused him any loss — just the contrary. The judge at first instance said, in effect, ‘If you cannot prove you have suffered any loss, I must find against you and refuse you any damages.’ The Court of Appeal reversed that decision, reaffirming the rule that a party who proves breach of contract is entitled to an award of damages. In this case they would be nominal, merely to show that there was a contract and that the rights under it were recognized by the courts. It may be unwise, however, to bring such an action because, if the court considers its time has been wasted or its processes otherwise abused, it may order costs against the successful plaintiff.

7.3.2 Damages as compensation. The usual purpose of an award of damages is to compensate the plaintiff for the loss caused by the breach. The object of damages is to put the injured party, so far as money can, into the same position as if the contract had been performed. The parties may themselves have provided in the contract their estimate of how much damage a certain kind of breach may cause and the amount they consider should be paid as compensation. If they have, the court will enforce their agreement unless it really inflicts a penalty; 8.2. But usually the court has to assess the damages without the help of any such agreement by the parties to fix them.
7.3.3 *Causation and remoteness.* The defendant does not have to pay damages for loss which was not caused by the breach. Therefore the plaintiff must first prove that the defendant’s breach caused the loss. The question is one of fact and the burden is that which is usual in civil claims, that the plaintiff’s contention is more likely on the balance of probabilities. If I hire you to take photographs of me, which you know I am going to submit with my application for a job as a model, and I fail to get the job, I am unlikely to be able to get damages from you if I allege your bad workmanship was the cause. It is just as likely my face was at fault as your photography. It is a question of fact which was the cause. The evidence of the potential employer might well be decisive.

Even if the injured party can prove that the breach caused the loss, no damages will be awarded if the damage is too remote. Whether damage is too remote is a question of law and is tested by the rule in *Hadley v. Baxendale* (1854) 9 Ex 341:

Where two parties have made a contract which one of them has broken, the damages which the other party receives for that breach of contract should be such as may fairly and reasonably be considered either arising naturally, that is according to the usual course of things, from that breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.

The party in breach must pay damages for the loss it should have contemplated, when it made the contract, as not unlikely to be caused if it broke the contract in the way it did. ‘Not unlikely’ is hardly a sharp criterion but no clearer one has been accepted by judges generally: *Koufos v. Czarnikow, The Heron II* [1969] 1 AC 350.

In *Hadley v. Baxendale*, the plaintiff had a mill. Its crankshaft broke and was sent for repair. The defendant was the carrier who transported it to the foundry. The defendant took an unreasonable length of time. The delay meant that the repaired crankshaft was returned later than it should have been. The mill only had one crankshaft, therefore it was idle until it was returned. The plaintiff lost his profits while the mill was idle. The defendant’s delay in-
creased that loss. There was no doubt that the defendant’s breach caused that increased loss. Could the plaintiff get damages to compensate him for that extra loss? The court said no. The loss did not arise ‘naturally, according to the usual course of things’. It was common for mills to have spare crankshafts. The plaintiff had not told the defendant that he only had one crankshaft. The loss which the delay would cause was therefore not in the defendant’s contemplation, at the time of the contract, as the probable (i.e., not unlikely) result of his breach.

But in *The Heron II* the result was the other way. Again the defendant was a carrier guilty of delay, in this case in delivering sugar. When it reached the market the price had fallen. This carrier, though, knew that the market was unstable. It was not unlikely that the price would fluctuate. It might well go up but it might just as easily go down, which it did. The loss that occurred ‘may reasonably be supposed to have been in the contemplation of the defendant, at the time of the contract, as the probable [not unlikely] result of the breach of it.’ Note that ‘probable’ does not mean a better than evens chance or more likely than not. Whatever it may mean elsewhere and whatever dictionaries say, in this context it means ‘not unlikely’ — whatever that may mean!

### 7.3.4 Measure of damages.

The purpose of damages is compensation; it is not punishment or deterrence. The plaintiff will recover only so much in money as is needed to make up for the loss sustained.

Having decided that the loss is not too remote, the court must quantify its value in money. When the kind of damage which requires compensation has been ascertained, the court must fix the measure of damages. The parties may fix that measure for themselves in the contract. If they have not, the court must do so, and has no discretion to raise or lower the amount to show its approval or disapproval of the parties’ conduct. The court must do its best to come to the right figure, however speculative the task may be. A plaintiff may prefer not to measure damages for the breach by estimating what damage the other party’s failure to perform has caused. Instead the plaintiff may choose to claim the expenses already incurred in preparing for or performing the contract before the other party’s breach. In *Anglia Television v. Reed* [1972] 1 QB 230 Anglia hired Reed to appear in a television programme. Reed repudiated the contract. Instead of suing Reed for the loss of profit,
Anglia claimed and recovered the expenses they had incurred in preparing for the programme, both before the time of the contract and after it, up to the breach. Reed must be taken to have contemplated that Anglia would suffer such a loss if he broke his contract.

7.3.5 Sale of goods. There are special rules relating to the measure of damages for breach of contracts to buy and sell goods. They are set out in SOGO ss53 to 56. The general rule in s53 follows Hadley v. Baxendale. The other rules are dealt with in detail in Goods 7.

7.3.6 Mitigation. The party in breach is liable in damages only for the loss the breach has caused, not loss attributable to the fault of the plaintiff. The plaintiff has a duty to mitigate, to do what is reasonable to keep the damages down. If a seller does not deliver on the due date, the buyer should buy from some other supplier at the cheapest available price, thereby keeping down the damages, which will be the difference between that best available price, that is the market price, and the contract price. Of course if the buyer does not have to pay more, the damages will be nominal. An employee who is wrongfully dismissed should try to keep down the damages by getting as well-paid a job as quickly as reasonable. Whether an injured party has done all that is reasonable to mitigate the loss is a question of fact depending on the circumstances of each case.

In Finlay v. Kwik Hoo Tong [1929] 1 KB 400, A agreed to sell sugar to B and to ship it to him in September. He did not ship it until October. A sent B a bill of lading which said that the sugar had been shipped in September. Relying on this statement, B sold the sugar to C, a merchant in Bombay, on the terms that the sugar had been shipped in September. The contract between B and C contained a clause which said that the bill of lading should be conclusive evidence of the date of shipment. B sued A for damages when he found the sugar had been shipped in October and not in September as promised by A. A did not deny that he had broken the contract, but he said that B had suffered no loss because he did not have to pay C anything. C could not sue B because of the clause which precluded C from disputing the date of shipment in the bill of lading. The English Court of Appeal held that B did not have to stand on the clause, thereby holding C to a contract which was unfair. B did not have to do an act which would ‘violate the standard of morality which should attach to an English firm of standing and would in fact ruin their credit in India’.
It is important to remember that the guilty party cannot force the other to accept the breach and thereby prematurely terminate the contract. The innocent party may refuse the repudiation and treat the contract as still subsisting. In *White and Carter v. McGregor* [1962] AC 413, A contracted to put an advertisement of B’s business on A’s litter bins which he sold to local authorities, and thereby to advertise B’s business for three years. Within hours of the contract being made, B wrote to A and repudiated it. A refused to accept the repudiation, and made the labels for the bins and displayed them for three years. He then sued B for the full contract price. The House of Lords awarded the plaintiff the whole price. It is important to note that this was an action for a fixed, liquidated sum, the price. There can be no mitigation of a fixed sum, only of damages; 6.5.2.

7.3.7 *Lump sums and interest.* If by getting damages the plaintiff gets the advantage of a lump sum now rather than periodical payments due under the contract from time to time in the future, then an accurate assessment of damages will make allowance for that benefit, reducing the damages to account for the acceleration in payment. Similarly, if the plaintiff has had to wait for what was due under the contract, the court will allow interest in assessing the appropriate compensation.

7.3.8 *Tax.* If the damages are not subject to tax in the plaintiff’s hands, the defendant will be ordered to pay only what the plaintiff would have received if tax had been paid. This allows a bonus to an employer who wrongfully terminates a contract of employment because damages in such a case are not usually taxable. The plaintiff does not suffer. The loss is borne by the state.

7.3.9 *Discomfort and distress.* There are recent cases where the plaintiff has recovered damages not only for financial loss caused by the defendant’s breach but also for associated distress or annoyance. There must be some element in the contract and the surrounding circumstances to show that the defendant should have contemplated the personal discomfort or distress. In *Hardwick v. Spence Robinson* [1975] HKLR 425, the plaintiffs hired the defendant architects to build them a dream home in Silver Strand Beach Road. The drainage system was badly designed and the house was frequently flooded. The High Court included in the award of damages an amount to
compensate for mental distress, emphasizing that this was not a purely commercial contract but one ‘with a very personal flavour’.

7.4 **Equitable Remedies**

Common law remedies, such as actions for damages or the price, are awarded as of right to a plaintiff who can prove breach or non-payment. If a common law remedy is sufficient to do justice to the plaintiff, equity will not intervene. If the plaintiff can show that the common law remedy is inadequate, the court may allow an equitable remedy. The court has a discretion. Equitable remedies cannot be claimed as of right.

7.4.1 *Specific performance.* Because this is an equitable remedy, the court will only order it when convinced it is necessary to do justice. Damages are usually enough to do that but, when they are not, the court may order the defendant to carry out the contract, with a decree of specific performance, instead of or in addition to an award of damages. Because no two pieces of land are the same, it is easier to persuade a court to order specific performance of a broken contract to sell land. But it is possible to get a decree of specific performance of a contract to sell goods, if the subject-matter is unique or there is some special reason why damages would not do justice; *Goods 7.* In *Sky Petroleum v. VIP Petroleum* [1974] 1 All ER 576, a decree of specific performance would have been granted of a contract to supply petrol, because at a time of oil shortages an award of damages would not have done justice. In fact the same result was achieved by an injunction; 7.4.2.

The court will not grant specific performance if the plaintiff’s conduct has not been equitable (compare the withholding of equitable intervention in *D and C Builders v. Rees*; 3.7.6.). Similarly if there was no consideration for the promise, even if incorporated in a deed. Or if there is a lack of what is called mutuality, that is that the plaintiff is not susceptible to a decree of specific performance, for example if the plaintiff is an infant. Because such a decree will not be made against an infant, it will not be made in an infant’s favour. There is no reason for this alleged rule, which depends on very old cases. An infant should both be able to ask for specific performance and also be subject to such a decree, if liable in contract at all; 11.2.
If the broken contract was an employment contract or to perform other personal services, the court will not force a party in breach to perform it by a decree of specific performance. The Court will not lend itself to such an oppressive or futile exercise. If the implementation of the decree would otherwise require the court’s constant supervision, as most building contracts would, the court will not usually grant the decree. Nor will the court grant specific performance if it would cause undue hardship to the defendant. In *Patel v. Ali* [1984] 1 All ER 576, A contracted to sell her house to B. She was then married with one child and in good health. By the time she was required to give up possession she had two more children, had lost a leg through cancer of the bone and her husband had gone bankrupt. She relied on her neighbours and friends in the community, who would help her to pay damages. Specific performance against her was refused.

On the other hand, a decree can be used to do justice where damages are not only not sufficient, they are not available at all, as in *Beswick v. Beswick*; 9.1.2.

7.4.2 *Injunction.* The court’s order may not be in the form ‘perform your contract!’ It may be negative: ‘Do not do something which would be a breach of contract!’ Injunction, another equitable remedy, is an order of the court prohibiting conduct which is a breach of contract. Like specific performance it may be awarded instead of, or in addition to, damages, and it may be available where specific performance is not, for example, where the breach is of a continuing or recurring contractual obligation. It was said above that specific performance would not be granted of a contract of service, but an injunction may have practically the same effect. In *Warner Brothers v. Nelson* [1937] 1 KB 209, A signed a contract to work as a film actress for B and for no one else for one year. During the year A signed a contract to act for C. B was granted an injunction restraining A from performing her contract with C which would have been a breach of her contract with B. It was not quite the same as a decree of specific performance. It did not directly compel A to work for B. But it clearly had that effect. A was not likely to work for someone else as a waitress. Injunctions are granted to enforce negative promises, promises not to do something. But the promise can be worded in a positive way and still be enforced by an injunction. In *Metropolitan Electric Supply v. Ginder* [1901] 2 Ch 799, A agreed to buy
all his electricity from B. B was granted an injunction which stopped A from buying his electricity elsewhere. The promise, though worded positively, was in effect not to buy electricity from anyone else.

An injunction will be granted not only where a breach has taken place but also where one is threatened or otherwise expected. It is important to remember that an injunction, like a decree of specific performance, will be granted only where damages are not a sufficient remedy.

A party to a contract may fear that irreparable damage may be done by the other party before the action for breach of contract is heard by the court, and may seek an injunction to stop it. Such an injunction, called an interlocutory injunction, can be used, for example, to stop a debtor disposing of assets.

7.4.3 *Rectification.* Where the court finds that the parties have failed to express in their written contract what both of them agreed on and wanted to express, then it will order that the written document be rectified; 5.5.

7.4.4 *Rescission.* Where one party can show that a contract is affected by the other’s misrepresentation, the equitable remedy of rescission may be available; 5.3.1.

7.5 *Tort*

A party to a contract injured by the other party’s act or omission may sometimes be able and prefer to treat it not as a breach of contract but as a tort. A fraudulent misrepresentation, for example, may give rise to an action in the tort of deceit; a negligent one in the tort of negligence.

7.6 *Quasi-contract*

A party injured by a breach of contract may prefer to seek a common law remedy in what is called quasi-contract, meaning that though it is not contractual, it is similar to a contractual remedy. ‘Quasi’ is a Latin word meaning ‘as if’.
7.6.1 *Total failure of consideration.* If a party to a contract can show that the other party has not performed at all, any money paid can be recovered. In *Rowland v. Divall* [1923] 2 KB 500, the buyer found out that the car was not the seller’s after he had used it for some months. If he had sued for damages he might have recovered a sum which would take into account the value of that use. Instead he recovered the whole of the price. The contract was a sale, that is a transfer of ownership. The seller had not transferred ownership because he never had any ownership to transfer. Therefore there was a total failure of consideration and the buyer could sue, not in contract but in quasi-contract, for the return of the whole price, being money handed over for a consideration that wholly failed. It is such an action that is used to recover property transferred under a contract void for mistaken identity; 5.4.3.

7.6.2 *Quantum meruit.* This remedy was discussed in relation to past consideration; 3.7.3. Where further performance is prevented by the other party’s breach, the injured party cannot usually sue for the contract price because not all that the contract required has been performed. But a sum will be awarded, not as damages but proportionately, for as much of the price as the performance of the plaintiff has earned, or deserves. Similarly, if the contract turns out to be void, then there has never been a contract under which the plaintiff could have acquired rights. In *Craven-Ellis v. Cannons* [1936] 2 KB 403, a company appointed a managing-director and he worked for it for some months before it was discovered that his appointment was void because he did not hold the necessary qualifying shares. The company had to pay him appropriately for his services, even though there was no contract between them.

Where an infant is provided with necessaries, under a contract voidable for incapacity, the supplier can recover a reasonable price for them — not the contract price — by suing on a *quantum meruit*; 11.3.2.

7.7 **Loss of Remedy**

A remedy for breach of contract may be extinguished in different ways. It has been shown that the injured party may agree to release the other from liability, in exchange for some valuable considera-
tion, that is, there may be accord and satisfaction. Another way in which the right to sue for breach of contract may be lost is by the passing of time. All restrictions on remedies are the subject of the next chapter.

**Points to Note**

1. When a contract is broken the injured party may do nothing; or negotiate; seek mediation or arbitration; use self-help; or sue for a common law remedy in debt for the price or other fixed sum or in an action for damages or in quasi-contract or tort; or seek an equitable remedy.

2. The advantages of doing nothing are avoidance of cost and offence to the party in breach.

3. The advantages of self-help are speed and informality but with the risk of committing some illegality.

4. The advantages of arbitration are informality and no publicity and perhaps a more expert decision-maker.

5. An action for a fixed sum in debt or for the price has the advantage that the plaintiff need not mitigate, or prove actual damage.

6. Every breach of contract gives rise to an action for damages.

7. The court must award damages even if the plaintiff can prove no loss.

8. The purpose of damages is to compensate for the loss caused by the breach.

9. The plaintiff must prove that the breach caused the loss.

10. The damage must not be too remote: it must arise naturally according to the usual course of things or must reasonably be supposed to have been in the contemplation of the parties, at the time they made the contract, as the probable result of the breach.

12. The court fixes the measure of damages, how much money is needed to compensate.

13. The special rules governing the measure of damages in sales of goods are set out in SOGO ss53 to 56.

14. The plaintiff has a duty to mitigate, to keep the damages down.

15. The party in breach cannot force the other to accept the breach as repudiation.

16. Allowances must be made both for premature and delayed payment and for tax saved by the plaintiff.

17. An amount may be added for personal discomfort or distress if the defendant should have contemplated it.

18. Equitable remedies are discretionary, common law remedies are as of right.

19. Specific performance will be granted only where damages are insufficient to do justice.

20. An injunction will be granted only where damages are insufficient; it may be granted even before the breach.

21. Specific performance or injunction may be granted instead of or in addition to damages.

22. Rectification will be granted only where both parties are proved to have agreed something different from what they wrote down.

23. Rescission is available at the court’s discretion where the contract was induced by misrepresentation.

24. There may be an action in tort for a breach of contract, either in deceit or negligence.

25. An action in quasi-contract arises where there is total failure of consideration, for money or property transferred.
26. An action on a *quantum meruit* arises where the other’s breach prevents further performance, or the contract is void, or for necessaries against a party without capacity.

27. A common law action is barred by passage of time by the Limitation Ordinance.

28. An equitable remedy may be lost by laches.
Chapter 8

Restrictions on Remedies

8.1 Remedies Fixed by the Parties

We have looked at the normal remedies available to people who are the victims of a breach of contract. If parties reach the stage where negotiations break down, and to sue seems the only possibility, then they would hope to go to court and receive whichever of those remedies was appropriate.

The normal situation does not always apply, and these remedies may not be always available. This may be because of the actions of the parties themselves, in drafting special clauses into their contracts. For instance, a contract may be drafted to limit the liability of one party, or to state a specific amount payable on breach, without waiting to hear what the court may have to say.

The restriction on the remedy may, on the other hand, be the effect of the law. Time limits in the case of common law remedies are fixed by legislation, and in the case of equitable remedies, we have already seen the effect of laches, which represents equity’s approach to the problems of time.

8.2 Liquidated Damages Clauses, Penalty Clauses and Deposits

Just imagine that a contract has been made between two parties. Xu Ltd. is to unload goods for Yan Ltd. and put them in Yan’s warehouse. Both parties know precisely what is likely to happen if Xu delays in the unloading, because they are able to calculate the loss to Yan in terms of dollars. Suppose they put the amount at five thousand dollars.

In that case, what could be more reasonable than to avoid the time, money and stress of a court action, and avoid arguments after the event? The parties can simply decide beforehand that for every
day that Xu delays, it will have to pay Yan $5,000. This clause is known as a liquidated damages clause. ‘Liquidated’ means that the sum of any claim is fixed beforehand. It may also be known as an agreed damages clause. The courts like to encourage people to settle sensibly. They do not want one party or the other to come rushing to court if the clause turns out not to have been an accurate estimate after all. The rule is, therefore, that the court does not ask whether the parties got their estimate right. The court merely asks whether at the time of contract the clause was, so far as the parties were aware, a genuine pre-estimate of what the loss was likely to be. The Hong Kong courts have shown that they are so eager for these out of court pre-settlements to be attempted, that they will even encourage them in cases where pre-estimation is extremely difficult. That is the message of *Luen Yick Co. v. Tang Man-kee* [1958] HKLR 405. The case concerned delivery of a machine, and so much per day was agreed to be the price of delay. The defendant protested that the circumstances were too complicated to make an accurate forecast of the loss. The court, whilst agreeing with the defendant on that point, held that the honest attempt at estimating damages had settled on a sum which was not wildly extravagant and bound the parties.

8.2.1 *Penalty or liquidated damages.* Let us look again at the case of the warehouse, set out at the beginning of this section. Suppose that Xu desperately needs the work, and Yan knows this and is in the stronger position. Then, Yan might take advantage of this strength by imposing a penalty clause. That is, it would choose some ridiculously high fee like $1 million per day of delay. This would be way above any likely loss forecast by the parties, and would serve the purpose of frightening Xu into keeping its side of the bargain by imposing a fine if it did not. This is a *penalty clause*. Furthermore, it is void. The parties to a contract are not permitted to impose sanctions on each other. This would be the present day answer to Shylock’s claim (in Shakespeare’s *Merchant of Venice*) to a pound of flesh in lieu of repayment of money. But it is only the penalty clause which is void. The contract itself would still stand. Yan could still seek damages in the normal way from Xu for whatever loss had been actually caused.

Telling the difference between a penalty and liquidated damages really requires just one question — were the parties genuinely trying to pre-estimate loss? There are various guidelines, set out by
the House of Lords in *Dunlop Tyre Co. v. New Garage Co.* [1915] AC 79 and followed in Hong Kong, for example, in *Luen Yick Co. v. Tang Man-kee*; 8.2. These are simply methods of deciding whether the clause is a genuine forecast of loss or not. If the sum chosen is wildly above what should have been foreseen at the time (the court deciding what that should be, of course) then it is a penalty; if several kinds of breaches of different gravity attract the same sum, it is likely to be a penalty, for it is unlikely that any careful pre-estimation was done.

8.2.2 *Discounts.* If A owes B $100, and the contract says that A will have to pay $150 if the $100 is not repaid on time, this is a penalty. However, though it is a penalty to demand a greater sum on failure to pay a smaller sum, there is nothing wrong with giving a discount for early settlement. Thus the same result can be achieved by careful drafting. If the market value of goods is $100, the seller can fix the price at $150, adding that ‘payments made before the end of 30 days from the date of the invoice are subject to a 33% discount’.

8.2.3 *Deposits.* Deposits work in a different way, but still assure payment of a fixed sum on breach, just like the liquidated damages clause. However, there is no need to claim the money after the event, for the deposit is paid in advance. You will be asked for a deposit when making an important purchase, where it is important to know that you are seriously intending to continue, for instance, when you buy a flat. The deposit is taken from you in advance to show that you are serious, and that you are likely to be able to afford to continue. If you do not continue, then you lose your deposit.

8.2.4 *Deposit or part payment.* There is no distinction analogous to that between penalty and liquidated damages to be made. The main distinction is between deposit and part payment in advance. A deposit is paid as a guarantee of performance, whereas a part payment carries no such guarantee. This means that you can keep a deposit if the other party fails to go through with the deal, though you must return it if you break the contract. The intentions of the parties must be our guide as to whether a payment is a deposit or not, and frequently the fact that the deposit is not returnable on failure to continue by the person paying it will be stated in the contract. Custom may dictate that a payment is a deposit in certain circumstances.
A part payment in advance, on the other hand, must be returned if there is a dispute, and the disappointed party must claim damages in the usual way. A deposit may be retained, and if it is insufficient, damages may be claimed to cover the excess. If the deposit is more than damages would be, there is no requirement to return the excess. There is no specific penalty rule governing deposits, nor are they subjected to the rule governing penalties and liquidated damages clauses, presumably because an actual payment has already been made. It has been tentatively suggested that equity would not allow a grossly disproportionate deposit (say 90%) to stand, but no case has decided the law for us.

8.3 Liquidated Damages, Penalty and Limitation Compared

Let us return to Xu and Yan, still dealing with that unloading and warehousing contract. We have seen that a genuine pre-estimate of loss might be $5000 and that a liquidated damages clause might specify that amount. We have also seen that a penalty clause of one million dollars would be void, because it sought to penalize one party. Such a clause could only be put in if Yan were the stronger party.

Suppose Xu were in the stronger position; suppose that Yan needed Xu’s services badly, and Xu took advantage of the position by safeguarding it in case of breach of contract. If we take $5,000 to be the likely pre-estimate of loss, then Xu might insist on a clause which said that in the event of delay, it would pay no more than the actual loss, or $100 per day, whichever were the less. This would be a limitation clause. It is not void, like the penalty clause, but it is not beloved by the courts, as is the liquidated damages clause. It is a form of exemption clause. It is valid, as long as it stands up to severe scrutiny by the common law and such statutory rules as may exist.

8.4 The Nature of Exemption Clauses

Nature and names. Though ‘exemption clause’ is perhaps the most popular, clauses attempting to restrict liability have many names. ‘Limitation clause’ is the term usually used to indicate that remedies
have been cut down, not out completely. Typically, such a clause will say that claims will be restricted in type or amount. For instance, a clause might say that goods may not be returned — which allows full damages to be demanded. A laundry may accept your clothes only on terms that they will be liable for $100 or the full amount of the loss — whichever is the less. An insurance policy may state that claims must be filed within seven days, or will be lost completely. The seller of seeds to farmers may restrict damages to the cost of the seeds. This final case is an example of where money back is a poor remedy. Think of the time, energy and money expended by the farmer after purchasing the seed. If the seed proves to be useless, a money back guarantee will meet only a small part of the claim.

An ‘exclusion clause’ suggests that no claim will be entertained. For example, the words ‘No responsibility is taken for any loss, damage or injury howsoever caused’ may be found on a notice at the entrance to a car park. They clearly envisage that you will have no claim at all.

‘Exception clause’ is sometimes used instead of ‘exemption’, but does not seem to have any different meaning. You can normally use exemption or exception clause to mean a limitation or exclusion clause. We shall stick to ‘exemption clause’ as the general term.

These clauses are extremely common and once you know what to look for you will find them everywhere. You will find them when you park your car, have your clothes cleaned, order goods on behalf of the firm (they should not be there when you order goods on your own behalf; 8.5) or enter into almost any other contract. They arise because people who provide goods and services usually also dictate the contract to their customers. In their attempt to shift the balance of favourable terms towards themselves, they will almost certainly try to alter the consequences of breach of contract.

Exemption clauses, considered in the general context of contract law, present an insoluble problem. If we allow the theory that in a contract the parties are free, within the law, to contract on whatever terms they wish, then we must allow the stronger party to include exemption clauses. Agreement to such a clause is often only apparent, but this makes no difference at all to the legal position; 8.5. On the other hand, we have seen that no one can expect to get something for nothing under a contract; 2.2 and 3.7. When I make a contract with you, I am saying to you: ‘I promise you that I will do
this and provide that in return for your money. Your safeguard is that, if I fail to perform my promise, you can sue me.' Yet, if I use an exemption clause, I say instead: 'I promise that I will do this and provide that in exchange for your money. If I do not perform my promise, there is nothing, or very little, you can do.' If you agree to this, what is the court to do?

At common law, the courts could do no more than check carefully to make sure that there was apparent agreement and that the wording was clear. Legislation was needed to protect weaker parties. We have already seen that agreement is objectively tested, and a person may be taken, by the law, to have agreed to something which he or she has not truly understood and does not really want (3.2). Hong Kong lagged behind other jurisdictions, but by the end of 1990 had the Control of Exemption Clauses Ordinance (CECO) (8.10). However, it is still necessary to look at the common law. CECO is a last resort. If a clause fails the various common law tests of validity, it will not be necessary to use the stricter rules of legislation. Generally, the common law strives to put into operation the agreement of the parties, whereas the Ordinance tries to make an unfair contract work fairly.

8.5 Construction of Exemption Clauses at Common Law

We will now look at the ways in which the court approaches exemption clauses. It must first check that there has been breach of contract, and check what remedy might be expected. Next, it decides what effect the exemption clause has on that remedy.

In order to test the validity of the exemption clause, we ask three questions at common law: ‘Has the clause been incorporated?’ ‘Has a party relied on it?’ ‘Is the clause worded clearly enough?’ If the clause passes all these three tests, we then ask whether there is any relevant ordinance (Figure 3).

8.6 Has the Clause been Incorporated into the Contract?

If a clause does not form part of the contract, it may be ignored and there is no need to apply CECO to it. To decide whether a clause is part of the contract, the following test is used. It is applied to any part of the contract, but is usually only necessary for clauses which
one party finds disastrous, such as an exemption clause. There are two sub-questions, depending on whether the clause is part of a written and signed contract, or whether it is part of a less formal dealing, and to be found on a ticket or notice or in a brochure.

8.6.1 *Is the clause part of a written, signed contract?* The rule is that those who sign contracts are bound by everything in them, whether they read them or understood them or not. By signing a contract, you announce your total agreement with all the matters in it.
L’Estrange v. Graucob [1934] 2 KB 394 settled that this was so even where the clause was in ‘regrettably small’ print, as long as it was legible at all.

The rule must be, never sign anything without reading it carefully and, if it is important enough, take advice. There are some legal provisions which may assist but these should be regarded as a last resort. They include:

8.6.1.1 Misrepresentation and mistake (non est factum); 5.2 and 5.4.4. Misrepresentation will suffice where the matter is between the parties to the contract, but mistake is necessary where a third party’s interests are affected by the contract.

8.6.1.2 Misrepresentation of the effect of the exemption clause. Misrepresentation normally makes a contract voidable. Where a party wrongly explains to the other the effect of an exemption clause, the contract is valid but the clause takes effect according to the explanation, whatever its actual meaning. In Curtis v. Chemical Cleaning and Dyeing Co. [1951] 1 KB 805, a woman who took a wedding dress to be cleaned was given a form to sign. The form contained an exemption clause. Suspicious, she asked about it. She was told that the clause protected the cleaners if anything should happen to the beads and sequins with which the dress was decorated. The clause excluded liability for any kind of damage. The beads and sequins survived the cleaning, but the fabric of the dress did not. The court decided that the actual meaning of the clause was irrelevant; what mattered was the meaning given to it by the explanation of a person appearing to be in a position of authority.

This does seem to suggest that if you do not understand a clause and have no time or money to see a lawyer, then you might try to let the other side illuminate the clause for you. If they refuse, then you should be suspicious and refuse to continue. Anyone who is over-anxious to have you sign a contract probably has good reason for not wanting you to reflect too carefully.

8.6.1.3 Overriding oral warranty. This is the name given to a statement made by one contracting party, personally or through a person seeming to be in authority. The statement contradicts a clause in the written contract, and the exceptions to the parol evidence rule will have to be invoked to allow evidence of the statement to be given;
4.5. However, once that is done it will be seen that the oral statement is more powerful than the written one in this case. A written exclusion is overridden by an oral promise. This differs from the example in 8.6.1.2 above in that there is no attempt to explain the clause; you are clearly informed that in this case there will be no exclusion against you.

8.6.1.4 Apart from these three cases, there really is no escape from a contract which has been signed. That is one reason why it is necessary to read any such contract very carefully. The unpleasant part is usually hidden away in the body of the document. It is not usually the last clause, because your eye might well fall on it during the signing process. You will almost always find that the last clause is harmless or even pleasant for that reason.

Nevertheless, on principles already discussed, if you are presented with a document in a language you do not feel comfortable in, then the best thing must be to ask for a translation. Any faults in translation will then be irrelevant, as you will be able to depend on what you are told.

8.6.1.5 If you refer back to non est factum (5.4.4.), you will note that there is rarely any excuse for signing a contract in English when one reads only Chinese, and vice versa. In Hong Kong business is transacted in two languages but only a small percentage of the population is truly bilingual. Most read only one language efficiently. There is no general legislation to deal with the problems. Many large companies, for example, produce quite complicated forms in English only and then use them in contracts with the Chinese community. Confusion can also be caused when the contract is in both languages, but with no clear indication of which is to prevail, and when translations have to be prepared for the court in order for judgment to be given. Remember the lum see agreement in 3.5.6.

Nevertheless, on principles already discussed, if you are presented with a document in a language you do not feel comfortable in, then the best thing must be to ask for a translation. Any faults in translation will then be irrelevant, as you will be able to depend on what you are told.

8.6.2 Is the clause written, but not part of a signed document? At this stage, we will ask you to conduct an experiment. Where are you
reading this book? Turn out your desk drawers and your pockets and your brief case or shopping bag. Do you have any tickets or bro-
chures on you? Are you in a library, and are there any notices about the safety of your belongings? Did you leave your car in a car park and was there a notice on the wall about what would happen in the event of loss or damage? The wall notices will usually be explicit, but the tickets (perhaps because of relative size) will be more allu-
sive and say that you are subject to the company’s terms and condi-
tions. It is up to you to find out what those terms are, now that you have notice that they exist. A holiday brochure may tell you that there is the possibility of a price rise, or that the firm is not respon-
sible if you are not allowed into the country where your holiday is to be spent.

There is no written, signed contract in existence but, if the piece of paper you are holding or which is on the wall contains an exemp-
tion clause, you may be bound by it.

Unfortunately, this area has been subject to more nonsense than almost any other area of law, and ‘ticket cases’ are often ‘com-
pletely divorced from reality’, as Huggins, J. complained in Wong Wai-chun v. China Navigation [1969] HKLR 471. He refused to believe that the general public in Hong Kong had a sophisticated general knowledge concerning the likelihood of exemption clauses in steamer tickets; 8.6.2.2.

The basic principle in ticket cases is that the clause must be incorporated into the contract by notice. To prove that this has been done, it may be shown that the person knew about the clause when entering into the contract. This is relatively straightforward but, of course, difficult to prove. It is not necessary to show this. All that need be shown is that reasonable steps were taken to bring the clause to the notice of the other person. In that case, whether or not the clause was read becomes irrelevant.

What reasonable steps are is a matter of the facts and circum-
stances of each individual case. There are some points to note, however.

8.6.2.1 Timing. The clause must be incorporated into the contract, and this means that it must be brought to the other party’s attention before the contract becomes final. In Olley v. Marlborough Court Hotel [1949] 1 KB 532, a notice in a hotel bedroom exempted the manage-
ment from liability for loss of goods from the bedroom. However, if
you think about the usual arrangements at any hotel, you will realize that the contract is finalized downstairs, at the reception desk in the lobby. A notice in the bedroom was too late, for the contract had been made already.

Note, however, the effect of familiarity. If Mr and Mrs Olley had been regular visitors to the hotel, they would have had an opportunity to see that notice on previous visits. Therefore on the current visit, it might be argued that they had notice of it. It is clear that one or two visits would not be enough. In *Kendall v. Lillico* [1968] 2 All ER 444, a term was incorporated from prior dealing. The two firms had had hundreds of dealings on the same terms. There must be a consistent course of dealings, so the visits to the hotel would have had to be many, and the same notice always displayed in the same place.

What happens if you buy a ticket over the counter? Surely, when you get the ticket, the contract has been made and the ticket always comes too late, because you pay first. The law analyses it differently: when you pay the clerk for a ticket to your destination, you make an offer. If the ticket contains an exemption clause not contemplated in your offer, then it is a counter offer. If you do not protest, you have accepted the counter offer.

If you buy a ticket from a machine, however, you have no chance to argue. Therefore, the setting up of the machine is an offer to you which you accept by placing your coin in the machine and no clause on the ticket can be effective because it will always be too late. You should therefore not be surprised to see notices on or by the machines. These principles were discussed by Lord Denning in *Thornton v. Shoe Lane Parking* [1971] 2 QB 163. A machine had been set up at a car park entrance, and it was clear that a clause contained in the ticket was ineffective, as was a clause printed on a notice inside the car park (at least on a first visit).

8.6.2.2 The type of document. Sometimes, a ticket provides proof of purchase or is proof of a right to reclaim an article. Should such a ticket be expected, in addition, to contain terms of the contract? Some of the older English authorities make a distinction between tickets which are contractual documents and those which are not, being ‘mere receipts’. *Chapelton v. Barry UDC* [1940] 1 KB 532 concerns a ticket which the court said was only proof of the right to occupy a beach chair for a certain period, and could not be expected to
contain terms. However, the decision can equally be explained on the grounds that the contract was entered into when Mr Chapelton helped himself to the chair (as he was invited by notice to do) and that it was too late, when the ticket was later issued to him, for its terms to affect the contract one way or another.

8.6.2.3 Remember what Huggins, J. said in the *China Navigation* case; 8.6.2. In *Yung Oi-king v. Beautcity Restaurant* (1981) HC No. 2708, 13 *HKLJ* 226, the court again decided that a general vague notion of what usually happened was not enough to give a person knowledge of the actual clause. The plaintiff admitted that he realized that such services were usually protected by some disclaimer of responsibility but contended that he did not have notice of any particular clause. The court agreed. Although the ticket did contain notice of a disclaimer clause, the notice was on the back of the ticket. The courts have got themselves into a strange position; they are ready to insist that people should have the general intelligence to read the front of tickets, but they are not ready to believe that they should, unprompted, turn a ticket over. The restaurant lost the case because the front of the ticket did not say ‘for conditions see back’ or some such message. The court declined to believe the attendant’s story that he clearly remembered handing over the ticket upside down, and the clause was ineffective because not incorporated. The general knowledge of the usual state of things was, it seems, enough to require the customer to glance at the ticket but not enough to require him to turn it over in further search of enlightenment.

8.6.2.4 So, to sum up as far as tickets go, it is usually wise to assume that the document will form part of the contract to the extent that, as well as providing some specific service such as showing entitlement to a seat on transport or to reclaim a suitcase, it can be expected to contain terms. Nevertheless, to be absolutely certain of incorporation, a wall notice may often be used in conjunction with the ticket — just in case the ticket is insufficient. The ticket alone will be insufficient to give notice if it comes too late in the proceedings (as it will invariably do if issued by a machine) or if the reference to the term is on the back, and there are no instructions to turn over.

8.6.2.5 *Unusual clauses.* Reasonable steps have to be taken to bring a clause to someone’s attention. What is reasonable depends on the
circumstances, and it has long been held that an unusual clause requires unusual steps. Which clauses are unusual? This really depends on expectation. In the *Beauty city Restaurant* case (8.6.2.3) the customer expected that there might be a clause of some kind exempting the restaurant for damage caused by its parking service. So no more than minor steps were needed to bring the actual clause to the customer’s attention. In the event, the steps taken were not sufficient. But suppose the clause had exempted the restaurant from personal injury suffered by the customer on the premises? This is not what one expects in a parking contract, which usually concentrates on damage to or loss from the car, and consequently the steps taken must be more definite.

*Thornton v. Shoe Lane Parking* (8.6.2.1) concerned a car park and a clause which in any case came too late. But on unusual clauses, Lord Denning had this to say: ‘In order to give sufficient notice, it would need to be printed in red ink with a red hand pointing to it — or something equally startling.’ When we realize that a trick played by less scrupulous firms is to make the clause as inconspicuous as possible whilst still passing the technical hurdle of incorporation, we see the need for the ‘red hand’ approach. In *Interfoto Picture Library v. Stiletto Visual Programmes* [1988] 1 All ER 348, the English Court of Appeal was not dealing with an exemption clause, but a clause of similar effect, in that it added unexpectedly to the burdens of the other party. The defendants had made a telephone inquiry about certain photographic transparencies and the plaintiff sent a consignment of about fifty along with a delivery note containing printed conditions. Condition 2 stipulated that the photographs must be returned within 14 days or a holding fee of £5 per day would be charged. The defendant did not read the clause and the holding charge amounted to almost £4,000 before the transparencies were returned. This was not a usual clause employed in the photo library business. Dillon, L.J. held that the requirements for incorporation had not been fulfilled. Special steps should have been taken to bring such an unusual and damaging clause to the attention of the defendant.

Unscrupulous businesses can still carefully calculate the narrow line between technical incorporation and actual notice, and tread it expertly. People may still be regarded by the courts as having agreed to something which they never read and were never meant to read. But the ‘divorce from reality’ is disliked by modern courts and the *Interfoto* case may signal the beginning of the end.
Has a party relied on the clause? The topic of privity of contract is dealt with fully in chapter 9. However, privity is important in the area of exemption clauses. Only a party to a contract can sue or be sued upon it, and only a party to a contract can shelter behind the exemption clause.

A contract may be made by a firm but carried out by its employees. The contracting party is the firm, and the firm will sue or be sued. However, it is expected that the employees will carry out the contract, and so their actions are the responsibility of the firm, and when we say the firm is in breach of contract we do so because of some wrong action by an employee in fulfilling the contractual duties. However, what if the firm has a full exclusion clause?

In that case, consider whether the employee has been negligent, or has committed any other form of civil wrong known as a tort. If the employee has done so, then an action in tort can be brought against the individual. Since the employee may not have much money and may not be able to pay the amount in damages awarded, you may think this is not practical. However, this is where the concept of vicarious liability comes in. If the person has committed a tort in the course of the employment, then the employer must pay the damages. This is a complex area of law, and is more fully discussed in tort textbooks. In Adler v. Dickson [1955] 1 QB 158, a passenger on a steamship suffered injury when she fell from its gangplank. She fell because of the careless handling of the plank by two sailors. Her contract contained an effective exemption clause against personal injury ‘arising from or occasioned by the negligence of the company’s servants’. So she did not sue the company in contract; instead she sued the servants in tort. She succeeded, and the company had to pay because of its vicarious liability. The clause only covered the company, and it only covered the company’s contractual liability. It is probably impossible to draft a clause which will cover the liability of one’s employees, although the question of covering one’s vicarious liability is more open.

Another common pattern of contracting, for example in the building industry, is sub-contracting. The employer uses a contractor, and the contractor brings in various subcontractors; 9.1 and Figure 4. Normally, the contractor is liable to the employer under the main contract, and so the contractor will be liable for any faulty work carried out by any subcontractor. Suppose a subcontractor is responsible for the flooring, and the floor is badly done. As far as the
employer is concerned, recourse lies against the contractor. The contractor must then sue the subcontractor for the damage suffered. In fact, the cases will usually be heard together but, because of the privity rules, they remain separate entities.

Suppose there is an exemption clause in the employer’s contract with the contractor which stops the employer suing the contractor. The employer would have been foolish or badly advised, since normally an employer must rely on the head contractor and both parties know this. Because of privity, the employer could not sue the subcontractor in contract. However, an action could be brought in tort, if appropriate; 9.1.1. The subcontractor could not then shelter behind an exemption clause in the main contract, not being a party to that contract. It might just be possible, however, for a carefully worded main contract to include the subcontractor as an agent. *New Zealand Shipping v. Satterthwaite (The Eurymedon)* [1975] AC 154 concerned the transporting of goods by company A and their unloading by company B, all done for company C. C contracted with A, and A brought in B. Normally, then, B would not be able to resist an action in tort brought by C. But A managed to extend the contractual relationship to include B. This was done by contracting once for A and again as agent for B, and including the exemption clause in both contracts. The Privy Council held that this is perfectly possible, so long as:
(a) the contract is clearly intended to protect B;
(b) A clearly contracts twice; once for itself and a second time as B’s agent;
(c) A has authority from B to do this;
(d) there is consideration between B and C.

The final point simply shows that there is a contract between B and C. Consideration is found simply in doing whatever is promised under the contract with A, since a duty owed by contract with A can be used as consideration in a contract with B; 3.7.6.1 and Figure 5.

8.7 Is the Clause Worded Clearly Enough to Cover the Damage?

The main principle to bear in mind here is that the courts will look carefully at the wording and try to expose any inadequacy. The *contra proferentem* rule has been mentioned before (4.7), and simply means that any gap or ambiguity will work to the disadvantage
of the person relying on the protection of the exemption clause. For example, suppose you enter a parking garage. As you leave your car, a piece of the roof breaks loose and falls on your head. The exemption clause (contained in a notice clearly visible to you outside the entrance) states that the management will not be liable for loss or damage to persons entering the car park, however it is caused. This clause does not cover your case, for you have suffered injury, and this is distinct from loss or damage. Suppose a clause states that all warranties, express or implied, are excluded. The court may then decide that what was broken was a condition or a fundamental term — or indeed anything but a warranty — and find that the clause cannot apply.

Examples of clear wording include:

No responsibility is taken for loss damage or injury howsoever caused.

This one contains all the modes in which damage is sustained. Loss could include total loss (an object is stolen or destroyed) and loss from an object (for instance, the theft of a car radio from a car in a carpark). Damage covers matters short of total destruction of goods, and injury covers persons rather than property. The words ‘however caused’ or ‘howsoever caused’ make clear that there is no responsibility no matter how the contract was broken.

In a different context, we might try:

All conditions, warranties and other statements whether express or implied by legislation, common law or otherwise, are hereby excluded.

This is similar to the clause in L’Estrange v. Graucob; 8.6.1.

8.8 Fundamental Breach

All the common law does, with the various tests, is seek the intention of the parties as shown in their agreement. However, the courts recognize that, in reality, the apparent intention does not reflect the true understanding of one of the parties — usually the less powerful party who finds action blocked by a carefully worded exemption
clause. At one stage, the proper application of the law became somewhat warped by the sympathy of some judges for the plaintiff in this situation, and the concept of fundamental breach flourished as a device to assist such a person, (fundamental breach is explained in 4.9).

8.8.1 *Suisse Atlantique*. The House of Lords stated in *Suisse Atlantique v. Rotterdamsche Kolen* [1967] AC 361 that there was no rule of law allowing a court to disregard an exemption clause just because a fundamental breach had occurred. The court must examine the circumstances and see whether the clause was intended to apply to the events which had occurred. However, for many years thereafter, the Court of Appeal gave only lip service to the House of Lords. That is, they operated special rules for fundamental breach whilst arguing that they were following *Suisse Atlantique*.

8.8.2 *Photo Production*. This was not challenged until *Photo Production v. Securicor Transport* [1980] AC 827. A security man was engaged to guard a factory. He burned it down. It is important to note that he lit the fire deliberately. There was a clause in the contract whereby Securicor stated that it would only be responsible for loss caused by its own negligence or that of its employees. The breach, although fundamental in nature, was not caused by negligence. It was found as a fact that it was intentional. The House of Lords stated that, therefore, it was clear that the clause did not actually cover the damage which had occurred, since the cause was very clear in its wording. The courts, not to mention academic writers, were very loath to abandon fundamental breach as a weapon against exemption clauses, and the House of Lords had to complain in *George Mitchell v. Finney Lock Seeds* [1983] 1 All ER 108 that fundamental breach was being brought in through the back door, after being kicked out of the front door in *Photo Production*. Cabbage seeds had not sprouted. The farmer was deprived of all the profit he expected from growing the vegetable, and had gone to a great deal of expense. The clause stated that damages were limited to the return of the price paid for the cabbage seeds. The lower courts were seduced by the argument that ‘cabbage seeds which will not sprout are not cabbage seeds at all’, and held that, as the clause referred to cabbage seeds, it was irrelevant! The House of Lords said that this type of logic chopping was no longer acceptable. The exemption clause effectively deprived the farmer of any remedy.
Hong Kong was left in a peculiar position. It is true that we are not bound by the House of Lords, but realistically we do not depart from its decisions unless there are clear indications that conditions in Hong Kong are such as to make the case irrelevant. However, what *Photo Production* did was to show that the line of cases on fundamental breach were bad in law. It was not possible for Hong Kong courts, if they wished to keep any credibility, to follow the earlier lead of the Court of Appeal. And yet *Photo Production* was decided at a time when the House of Lords could confidently say that injustices would not be produced by returning to the true meaning of the common law, since legislation in place in England would give protection. It became clear in Hong Kong very soon that the courts would follow the House of Lords. In *OTB v. Au* [1980] HKLR 296, the Court of Appeal applied *Photo Production*. The clause, which was probably not an exemption clause, was of a truly horrific kind at one time frequently found in credit card agreements in Hong Kong but which now seems to have been abandoned. Mr Au had his credit card stolen and reported by telephone immediately. A clause in the agreement held him liable for all losses sustained until written notification was received by the card company. The lower court held the clause too unfair to apply, but the Court of Appeal looked at the wording and, finding it clear, applied *Photo Production*. Thus our courts were quick to learn the lessons of *Photo Production*, though it took ten years for the legislation to give the same protection as in England.

### 8.9 Other Problems of Construction of Exemption Clauses

#### 8.9.1 Application of the clear wording test in Hong Kong

In *Yeu Shing v. Pioneer Concrete* (1987) HCA No. 36, a contract was signed for the supply of concrete. The defendant repudiated and one of its defences was an exemption clause protecting against failure to deliver. The court read the clause carefully and was able to conclude that the contract was for delivery at various times as individual orders were placed. The exemption clause protected the defendant against failure to deliver any particular order. It did not protect against repudiation of the entire contract.

#### 8.9.2 Limitation clauses — a different standard?

It was suggested in
Ailsa Craig Fishing v. Malvern Fishing [1983] 1 All ER 101 that the court should be less severe on limitation than exemption clauses. A limitation clause often found in left luggage offices or cloakrooms would say, for example, ‘on breach of this contract no more than the worth of the article or $2,000 (whichever is the lesser sum) may be claimed’. Although it is not clearly expressed in the Ailsa Craig case, the rationale is that full exclusion is so severe that it warrants severe treatment, whereas limitation is more likely to be fair. This is really a matter of degree, however. A limitation clause can limit the remedy so severely that it is hardly any better than a full exclusion clause. Suppose the clause above limited the claim to $10? Is that much better than nothing at all? It may well be that a careful reading of the judgment in the Ailsa Craig case would limit it to the exemption of negligence.

8.9.3 Negligence. At common law, a generally worded clause was held not to have been intended to cover negligence, unless negligence was the only possible cause of loss, damage or injury. Words which refer specifically to negligence or phrases like ‘howsoever caused’ were needed to exclude liability for negligence. The special rules of construction relating to negligence existed because it was felt particularly unfortunate that someone should refuse to take liability for negligent acts in the performance of a contract. Now it is less necessary to apply the tests of clear wording so strictly, since CECO deals specially with this topic (8.10.3). Nevertheless, where property damage is concerned there is still an advantage in removing the clause from consideration totally, to avoid the reasonableness test (8.10.6).

8.9.4 Summing up of clear wording requirement. What the common law can do is limited to a scrutiny of the wording in order to put into effect what the court decides are the presumed intentions of the parties. It is therefore possible for a person to enter a contract with no idea that it contains an exemption clause, since at common law the presumed intention may not refer to actual intention. Presumed intention is gathered from such actions as signing a contract or accepting a ticket. The action says to the court that the contract has been accepted as it stands, unless special factors are present.

The common law suits well-matched businesses negotiating with bargaining power. It tends to be to the disadvantage of ignorant
Restrictions on Remedies

consumers, or small businesses doing deals with large and powerful concerns, and leaves room for exploitation.

8.10 Control of Exemption Clauses Ordinance

The common law does not allow a judge to question the reasonableness of a clause, if it is clearly worded and is incorporated according to the rules of common law set out above.

The Control of Exemption Clauses Ordinance (CECO) now brings a more comprehensive system of relief based on the English Unfair Contract Terms Act 1977 (UCTA). It replaces the piecemeal legislation found in the Misrepresentation Ordinance (Cap 284) and the Sale of Goods Ordinance with a more general series of rules. Exemption clauses are widely defined in s5 to include notices as well as clauses in contracts, and to cover exclusion or restriction of remedies or rules of evidence and procedure.

The Ordinance is not confined to finding and enforcing the intentions of the parties. There are two types of relief that can be given — either the clause may be void, or it may be void insofar as it cannot be shown to be reasonable — this is discussed further at 8.10.6.

8.10.1 The Ordinance applies — with a few exceptions — to business liability (which is defined in s2(2)). This means that the person seeking the protection of the clause cannot do so in a private capacity. However, it is unusual to find complex clauses outside a business setting, so this will in practice be of little importance.

8.10.2 In order to use the Ordinance, it is necessary to decide what kind of a contract we are dealing with. If it is a sale of goods and there is a breach of one of the terms implied by SOGO, then the law is as it used to be under SOGO s57. The provisions are now to be found in s11 CECO. What is new, however, is that in s12 CECO the protection is extended to other types of contracts where goods change hands (eg, hire, barter) insofar as there are terms implied at common law similar to the statutory ones. This is the rather vague provision which was to be found in the original English s7 UCTA. Since that time in England, all such terms have become statutory (under the Supply of Goods and Services Act 1982) and s7 has been altered to
take account of this. Hong Kong has no such Ordinance, and therefore has to be content with a reference to an obligation 'arising by implication of law from the nature of the contract'.

What both these sections do is to forbid exclusion of s14 SOGO, which promises that the seller has a right to sell, or any analogous common law terms, in any contract. However, the other SOGO implied terms (and their common law equivalents in other goods contracts) are treated in a more complex way. We have to decide whether or not the transaction was a consumer transaction. Note that this is not a test of whether the buyer was a consumer. The test set out in s4 is threefold:

Did the seller sell in the course of a business?
Did the buyer neither buy, nor hold himself out as buying, in the course of a business?
Were the goods of a kind usually sold for consumer use?

If all three tests are passed, then the exemption clause is void. Otherwise, a reasonableness test applies, (described in 8.10.6). As to the test in s4, note that the requirement that the seller must sell in the course of a business does more than just repeat the general requirement of business liability in s2. Section 16, merchantability and fitness, is perhaps the most important of the implied terms, but does not come into the picture here. That is because the section is not even implied in the first place unless the seller sells in the course of a business. However, s15, that goods must answer their description, applies to all contracts of sale, and so does s17 that goods sold by sample must agree with the sample. In these cases, because the term is implied into a sale by a private seller, the general requirement of business liability is relaxed. The odd thing arising out of this is that, because of the definition of a consumer transaction, a private seller selling to a private buyer forms a non-consumer transaction.

For example, Steven advertises his private car for sale as 'a 1985 Nissan', and sells it to his neighbour Bill. The car must answer its description, and if it is an earlier model there will be a breach of s15 SOGO. If Steven had attempted to exclude any liability — for instance, by saying that 'the car is sold as it stands' such clause would not be automatically void, because this is not a consumer transaction — even though, loosely speaking, we might have considered Bill to be a consumer.
Further, as to the second and third requirements, a buyer who pretended to be in business so as to claim trade discount, for example, would 'hold himself out as buying in the course of a business'. What goods are normally sold for consumer use? The Ordinance does not help, but it is clear that there must be certain goods in that category. A double decker bus or a complete set of scaffolding, perhaps.

8.10.3 Where we are not dealing with contracts relating to goods, there are two possibilities. For these, we have to decide the mode of breach. One possibility is that the contracting party was negligent. For instance, an electrician rewires Clara's flat very badly, so that a switch becomes live and she is injured, and fire damages her furniture. The electrician did not do this deliberately, but we cannot escape the conclusion that he was careless, or unskilled. This will be sufficient to establish a negligent breach of contract under s7. What is required for negligent breach is defined in s2 and it is clear that there is no need to establish the duty of care required in the tort of negligence, although this type of negligence is also caught by the definition in s2 with regard to notices excluding, say, the liability a person might have under the Occupier's Liability Ordinance. Having established a negligent breach of contract, we now have to decide a further matter, just as we did with ss11 and 12 before we could apply them. However, note that the question of whether or not Clara is a consumer is irrelevant when considering exclusion of negligence liability under s7. We ask what sort of harm she has suffered. As far as personal injury (or death) is concerned the clause is void. But as to any property damage or other sort of pecuniary loss, the clause is subject to the reasonableness test (explained below at 8.10.6).

8.10.4 If we cannot say that the breach was caused by negligence, and the matter is not related to implied terms in goods contracts, then we must go to s8. This is phrased pretty widely, and covers any case where a person uses a clause to restrict or escape from obligations altogether, or to allow a substitution of a different obligation. For instance, Peter books a holiday and finds a clause which says that the holiday company will hold itself able to substitute a different resort, or a different hotel, or a different week. The Company substitutes something which Peter finds unacceptable. Peter will
need to use s8 to challenge that clause. Section 8 has an entrance requirement. To be protected by it, Peter must either make the contract on the firm’s written standard terms, or make it as a consumer (using this time only the first two requirements set out in the test in s4, see 8.10.2 above). He would probably qualify on both counts, but only one is needed. Once he qualifies, the reasonableness test will always apply as this section does not make any clause void.

8.10.5 There may be a choice between using s7 and s8. However, if there has been personal injury, then it is obviously advantageous to use s7, since the clause will be void. In any other case under s7 or s8 the reasonableness test will be applied.

Parties to contracts specially negotiated between two businesses will be protected in the same way as private persons against negligence under s7, but will not come within the 'entrance requirements' for s8 described in 8.10.4.

8.10.6 Throughout, we have made references to a test of reasonableness. This is to be found in s3, and is slightly different from the one in the old s57 SOGO, since it only allows matters up to the time of contract to be considered (s57 SOGO went past that point and considered matters up to the time of trial, including attempts to negotiate settlement.) The term must now be a fair and reasonable one to have included, bearing in mind circumstances which were known to the parties, or those which ought to have been known to them up to the time of contract. Thus, there is an objective element. There are some (non-exhaustive) guidelines given in Schedule 2 as to the application of the reasonableness test. These guidelines specifically apply only to the goods sections — 11 and 12 — but can be applied by analogy to cases involving ss7 and 8 (negligence and express breach). These guidelines do not entirely follow the SOGO mode. Especially for Hong Kong's circumstances, the question of which language was used for the contract is mentioned as a test of reasonableness. Obviously, to give a Chinese person with little command of English a complicated document in that language, and expect that person to understand an exemption clause, is not reasonable. The original guidelines remain. In particular, the court must take into account the relative bargaining power of the parties. This means that, even in cases where it is not relevant whether or not the
transaction is a consumer transaction, or for some technical reason, such as the nature of goods purchased, the transaction does not come into this category, the fact that the plaintiff is a private person facing the might of a large company will be taken into account. The other guidelines are more specific, and include 'double pricing' — that is, where a person is given a choice of a lower price with no guarantee of quality and a higher price with full protection. In the end, it must be a decision based on all the facts and circumstances of the case.

Consider the situation where a consumer buys a television set from a retailer. By SOGO s16 that television must be merchantable, and it is a breach of condition if it is not. The customer can return it if, for example, it has no picture. By s57, no exemption clause can restrict this right of the consumer. But what of the retailer? Either the retailer must absorb the loss, or sue his or her supplier in turn. If that supplier has used an exemption clause, then the test of reasonableness comes into play to decide if the loss can be passed on.

What is reasonable is very much a question of opinion. However, the English courts have formulated several rules which help to maintain consistency. Hong Kong courts are likely to follow them. They include:

1. The Court of Appeal will not interfere with the decision of a lower court on reasonableness.
2. If there is more than one clause, each may be separately tested, so that one may be reasonable even if the other falls.
3. Findings of reasonableness do not create precedents. The same clause may be reasonable in one case but not in another.
4. If a clause is contained in a standard form contract and has been used for many years, it is more likely to be found reasonable, but this is not conclusive.
5. A clause which passes the test of incorporation at common law may still be declared unfair, because the court looks at the true situation and not at the rules on apparent intention.
6. Deliberate use of mystifying words and obscure location in a long contract may amount to unreasonableness.

8.11 The Passage of Time

A balance has to be struck between discouraging contract breakers by allowing those injured by breaches of contract to sue for dam-
ages, and encouraging those injured parties to sue promptly, so that
the parties allegedly in breach can get evidence with which to
defend themselves while it is still available. Common law claims are
subject to limitation periods set by legislation and are said to be
‘statute-barred’ even in Hong Kong which has ordinances rather
than statutes. Equitable rights are not affected by limitation periods
but may be lost by laches.

8.11.1 *The Limitation Ordinance.* The Limitation Ordinance (Cap 347)
provides that an action on a contract is barred after six years from
the date when the cause of action arose. If the contract was incorpo-
rated in a deed the period is twelve years. It is important to note that
as a general rule in actions for breach of contract the period begins
to run from the time of the breach, for it is then that the right of
action arises. But the start of this period may be postponed if the
injured party, the party suffering from the breach, is under a disabil-
ity or the other party conceals the right to sue.

If at the time of the breach the injured party is an infant or
suffering from some mental disability the period does not begin to
run. The injured party has six (or twelve) years from regaining
capacity or mental health. If the infant or mentally ill person dies,
then the personal representative has six years from the death to bring
the action. If the incapacity occurs after the cause of action has
arisen, then it is ignored and the period continues to run in spite of
the incapacity. Where the cause of action is not known to the injured
party, because the cause of action itself arises from the fraud of the
other party or the mistake (in the narrow legal sense) of the injured
party, then the limitation period starts from the time when the cause
of action was discovered, or ought to have been discovered, by the
injured party. Even if the cause of action does not arise from fraud
or mistake, the period will similarly be postponed where the party
guilty of the breach has concealed the existence of the cause of
action from the injured party.

If the cause of action arises in respect of a debt or other fixed
sum, and the debtor acknowledges the claim in writing or makes a
part payment of it, the right of action arises afresh on the date of the
last written acknowledgment or part payment. This means that a
statute-barred debt may be revived after the period has expired. A
new limitation period of six or twelve years as the case may be will
start to run afresh from each written acknowledgment or part pay-
ment, whether or not the original limitation period has expired.
Although the Limitation Ordinance bars the remedy, the injured party keeps the rights but cannot sue for them. The statute-barred debt remains payable. It cannot be enforced by action, or by set-off, but if the debtor pays money to the creditor, to whom the debtor owes debts some barred and some still current, without stipulating to which debts the payment is to go, the creditor can appropriate the payment to the statute-barred debts.

8.11.2 Limitation clauses in the contract. The parties may fix their own limitation period in the contract. They are not likely to extend the periods fixed by the Ordinance but limitation clauses often reduce the period within which an action can be brought sometimes to as little as a few days. The courts view such clauses with almost the same dislike as exemption clauses.

8.11.3 Securities. If the creditor has taken a security, such as a mortgage, then the right to recover on it will continue, even though the right to sue on the debt has become statute-barred.

8.11.4 Laches. The Limitation Ordinance does not apply to equitable remedies. The rights to specific performance and injunction are outside its provisions. But the courts apply a similar principle, known as laches. If the injured party has been guilty of unreasonable delay in enforcing rights, and the period is often much less than the statutory six years, or has otherwise acquiesced in the wrong done, the court will not exercise its discretion to grant relief.

8.11.5 Torts. An action in tort is also barred by the Limitation Ordinance after six years (three if the claim is for damages for personal injuries). But the period may end at a time different from the limitation period in contract, even though the same act gives rise to both actions in tort and contract. That is because the period may start at a different moment. That moment is, in a contract claim, the time of the breach; in a tort claim, the time when the damage occurs. The distinction is important, for example, in building contracts. If the builder has used poor quality reinforcing rods in breach of the contract, the building owner will lose the claim in contract six years after that breach, unless fraud or concealment can be proved. But the six years in tort will start to run when the damage happens, which may be many years later.
Points to Note

1. The parties may fix the amount of damages in the contract.

2. If the amount is not a genuine pre-estimate of the loss it is a penalty and will be ignored.

3. A discount provision, though a penalty in reverse, will not be disallowed.

4. A provision for forfeit of a deposit is not a penalty.

5. A part payment differs from a deposit in that it must be returned in case of a dispute.

6. A clause limiting the amount to be paid as damages is not a penalty.

7. Exemption (or exclusion) clauses are inserted to restrict the liability of one party.

8. Exemption clauses are construed strictly contra proferentem.

9. The proferens must show:
   (a) that the clause has been incorporated in the contract, either by inclusion in a written contract or by notice;
   (b) that the clause covers the event.

10. Notice must be given before the contract is concluded.

11. An exemption clause can be incorporated impliedly from a previous, consistent and copious course of dealing.

12. A ticket will not be sufficient notice unless an exemption clause, or a reference to an exemption clause, can be expected to appear on it.

13. A party who has signed a contract is bound at common law by all the clauses in it, including exemption clauses, even if in small print or an unknown language, but CECO may give relief. Study carefully 8.10 to 8.10.6, explaining how CECO works.
14. If the other party can show that the proferens gave an overriding warranty or misrepresented the effect of the clause, the proferens cannot rely on it.

15. Reasonable notice means reasonable to the recipient, including the language recipients may be expected to know.

16. An exemption clause will protect only the proferens, and not strangers to the contract.

17. The proferens may contract for itself and as agent for a third party, so that the exemption clause protects the third party, but only if:
   (a) the intention to protect the third party is clear;
   (b) the proferens contracts for itself and separately as agent for the third party;
   (c) the proferens has the necessary authority;
   (d) the third party gives consideration.

18. There is no rule of common law that an exemption clause cannot cover a fundamental breach. Whether it does is a question of construction of the contract.

19. A generally worded clause will not exclude liability for negligence.

20. By Misrepresentation Ordinance s4, any attempt to exclude liability for misrepresentation is valid only so far as it is reasonable.

21. By SOGO s57 some exemption clauses are void if they exclude liability for breach of the conditions:
   (a) that the seller has a right to sell; or
   (b) (in a consumer transaction) the conditions under ss15–17.

   Other exemption clauses must be reasonable.

22. The Limitation Ordinance bars an action for breach of contract, or the price, or for debt, six years after it arose. If the obligation arises from a deed, the period is twelve years.

23. Incapacity prevents or postpones the period running.
24. Acknowledgment or part payment of a debt refreshes the right of action.

25. The parties may fix their own period of limitation.

26. Securities are not affected by limitation periods.

27. Equitable remedies are not affected by the Limitation Ordinance but may be lost by laches.

28. An action in tort is barred by the Limitation Ordinance six years after it arose, but after three years if it is for damages for personal injuries.
Chapter 9

Parties to Contractual Rights

9.1 Privity

Only a person who has paid for another’s promise can sue on it — that requirement of consideration was explained in 3.7. We also saw in 8.4 that only a party to a contract can rely on an exemption clause in it. There is a general rule: only a party to a contract can sue or be sued on it. That is the rule of privity of contract.

Chains of responsibility tend to grow in everyday commercial transactions: manufacturer to wholesaler, wholesaler to retailer, retailer to customer. But the relationship in contract is link to link, and it is not possible to skip a link. If you were to buy a compact disc player from a shop in Tsim Sha Tsui, and something went wrong with it, you would have to look to the shop for your remedy. You do not usually have a contract with anyone else, unless there is a guarantee. The implied terms in SOGO do not depend on fault. It is no excuse for the seller to say: ‘I did not make the machine and it is not my fault that things went wrong.’ Sellers are responsible no matter what the reason for the fault. However, if your seller is right, if it is not the fault of the shop, it can sue the wholesaler, who must go back one more step in the chain, to the manufacturer of the player, or even the manufacturer of a faulty part sold to the manufacturer of the player. Clumsy? Perhaps, although there are procedures to allow a court to hear all cases in a linked chain of responsibility at the same time if it seems reasonable to do so. They will still be regarded as separate actions on separate contracts.

Multiple hearings on similar chains may arise out of building disputes between subcontractors, contractors and employers. A person who requires a building will employ one contractor to be responsible for the erection of it. It is never envisaged that the contractor will do all the work. But the contractor is better equipped than the employer to find the right people to do the plumbing, put in the flooring, deal with the tiling and so on. Because of the doctrine of
privity of contract, the employer can hold the contractor responsible in damages for faulty work by any subcontractor but cannot sue the subcontractor. The contractor, of course, then sues the subcontractor to recoup those damages.

9.1.1 Privity and tort. Contract is not the only method of recovering damages at common law, and the chain may be avoided altogether by an action in tort. Thus, the buyer of faulty goods may sue the manufacturer of the goods and the employer the careless subcontractor, cutting out the persons in between. After all, that is where ultimate responsibility lies. If the contractual action is still available, it may be better to use it than to proceed in tort. A plaintiff bringing an action in the tort of negligence must prove all the elements — that a duty of care existed, that it has been broken and that the plaintiff has suffered loss of a kind which can be compensated in tort. In the case of a buyer of goods, the contract action is simpler because all that needs to be proved is the purchase of goods which are faulty. Lack of negligence in the seller is no defence in contract. An employer who sues a subcontractor must also establish negligence. Moreover, contract recognizes that your breach may cause me to lose money without any physical loss or damage but tort has found this very difficult to accept.

The advantage of a tort action is when the contract action is blocked. Perhaps there is an exemption clause which prevents a contract claim. Perhaps the contracting party is bankrupt and not worth suing. Sometimes, however, it is the privity rule which makes it impossible to bring a contract action. That is what lies behind one of the most influential cases in tort law, Donoghue v. Stevenson [1932] AC 562, regarded as responsible for the growth of the modern tort of negligence. It almost certainly arose because the law of contract was unable to help. A woman went to a restaurant with a man friend. He bought her a bottle of ginger beer. The bottle was opaque, and she poured half a glass and drank it. When she refilled her glass, part of a decomposed snail slid out. She became ill with shock and gastric upset. Consider the position. In contract, the friend could sue as the goods were certainly not up to standard. But what loss did he suffer? Today, there might be a way in which he could claim losses on her behalf (9.1.9) but such a claim did not exist then. Mrs Donoghue suffered loss, but did not make the contract. Even though the ginger beer was bought for her benefit, she
could not sue in contract. She had made no contract. But she sued successfully in the tort of negligence.

9.1.2 Benefits for third parties. But why was it so difficult for Mrs Donoghue? Why should she not sue in a case which arose from a bottle bought for her pleasure? We need to look more closely at why and how privity can cause difficulties for a third party. It is easy to understand the reason behind the doctrine of privity. Contract consists of promises made by parties to each other which can be enforced by the machinery of the law. But because the liability arises from the promises of the parties and not from the general law, it seems reasonable to restrict enforcement to the parties. If Amy promises to sell Benny a book, and fails in her promise, then it is for Benny to take action. If he does not choose to do so, then it is not possible for an indignant friend, relative or member of the public to intervene.

But if we may make our contract in any terms we wish (within the law, of course), why should we not make a contract to benefit another person? Xu may say to Yan: ‘I will build a house for you, but you must pay all the proceeds in instalments to my parents.’ However, if Yan fails to pay, the person who must sue is Xu. His parents cannot. Suppose he has gone to Saudi Arabia for a few years to build a palace. That may be why he arranged to have the money paid to his parents, to support them in his absence. Why should Xu’s parents have no right to sue Yan? Because they are not parties to the contract. That seems logical but unfair. In Beswick v. Beswick [1968] AC 58, Mr Beswick had sold his coal business to his nephew in return for a pension for his life which they agreed would be paid to Mrs Beswick, if she survived him. Mr Beswick died, the nephew did not pay and Mrs Beswick sued. Mrs Beswick got her money, because as administrator of her late husband’s estate she was entitled to sue for specific performance of the contract in her husband’s place; and the money was then paid to her in her capacity as widow.

The House of Lords saw no problem in the widow’s right to sue as administrator but refused to relax the doctrine of privity to allow her to sue in her own right.

In general, third parties cannot sue on a contract made for their benefit. Even more clearly, they cannot be liable under someone else’s contract. However, in the interests of fairness, several exceptions have been allowed.
9.2 Exceptions to the Privity Rule

9.2.1 Legislative exceptions. Several ordinances contain exceptions. The Married Persons Status Ordinance (Cap 182) allows a life policy to be taken out in favour of spouse and children. Normally when a person dies, all money, including insurance payments, go into the estate. It may be some time before the estate can be divided amongst the beneficiaries. Dependants could suffer. Therefore, a policy taken out under this ordinance is a useful device, for the proceeds go straight to the spouse or children without going into the estate, and the family has money to live on in those months during which the estate is being wound up and, because they can sue for it themselves if necessary, they can give insurance companies valid receipts.

Motorists often take out a policy protecting themselves and either a named driver, or anyone driving with their permission. If an accident occurs when such a person is driving, that person can claim on the motorist’s insurance. The policy is between the motorist and the insurance company. The only reason why a non-party can claim is that privity in this instance is set aside by Motor Vehicles Insurance (Third Party Risks) Ordinance (Cap 272) s6.

9.2.2 Land Law. Although the buying and selling of interests in land involves contract law, the nature of land has meant that some special rules have evolved. Many of them are statutory, but not all. In particular, privity of contract would be a problem in the area of leases. If Terry takes a lease from Lily, then there is no problem in enforcing a rule which says that Terry must not keep pets in his 15th floor flat. However, what if Terry transfers his lease to Peter? How can Lily enforce the contract against Peter? She can do so, through the doctrine of privity of estate, since they are in the relationship of landlord and tenant. So, if Lily sells the flat to Ann, Ann can enforce the lease against Peter, and Peter against Ann. There are other provisions to defeat strict privity and allow the benefit and the burden of such land agreements to be tied to the land rather than the contract, but they cannot be dealt with in an introductory book on contract law.

9.2.3 Agency. The doctrines of agency allow a person to create valid contractual ties between two other people, whilst not taking any personal liability; 9.3 and Business Associations 1.
9.2.4 **Equity.** Equity enters the picture in two ways. First, the creation of a relationship between two persons by which a third is to benefit comes extremely close to the concept of a trust. Could it be argued that when Xu contracted with Yan in 9.1.2, what he was really doing was setting up a trust with Yan as the trustee, himself as the settlor, and his parents as beneficiaries? If so, the problem is solved, since the beneficiaries are able to bring an action against a defaulting trustee.

In reality, it is rare to read a contract as a trust. The setting up of a trust requires clear wording. A person who wants to avoid the privity rule by setting up a trust must do so clearly at the outset. A trust cannot usually be inferred from the mere intention to benefit a third party. In most cases that follows the parties’ intentions. Take Xu’s case. If the agreement there had set up a trust, then the subject matter would be fixed and it would not be open to Xu and Yan to alter the terms of that contract without Xu’s parents’ consent.

The other way in which equity enters the picture is through assignments. The benefit of a contract could not be assigned at common law but could be in equity. Now there is a legislative form of assignment; 9.4.

9.2.5 **Suing a third party.** It is rarely fair to place a burden on someone without allowing them a chance to accept or refuse to be a contracting party. The main exception is found in land law, where a person buying the interest of a tenant will be subject to clauses in the original tenant’s contract with the original landlord; 9.2.2. Agency, too may provide apparent exceptions; 9.3.

9.2.6 **Collateral contracts.** The construction of a collateral contract by the courts is a device which has been used to allow a person to be sued where at first sight it would appear there is no contract. The main purpose is to defeat the privity rule. A collateral contract springs out of and depends on a main contract; it cannot exist alone. We have seen examples of collateral contracts between the same parties; 4.8. A guarantee contract is always collateral, since it guarantees performance of a main contract. Moreover, the courts have used the device of collateral contract to create responsibility where the parties were not consciously forming a contract, but where one party ought to undertake liability to the other. The liability arises because a person makes a statement to another which causes that
person to enter into a contract with a third party. This is not misrepresentation, because a representation must be made by one contracting party to the other.

In *Andrews v. Hopkinson* [1957] 1 QB 229, a customer saw a car which he liked in a dealer’s showroom. The dealer said to the customer, ‘It’s a good little bus; I’d stake my life on it.’ The customer then went ahead with the hire purchase contract, by which the dealer sold the car to the finance company, and the finance company let the car to the customer on hire purchase. There was something wrong with the car. In England then, as in Hong Kong now, the hirer had no right to sue the finance company. The terms about quality implied in the hire were freely excludable and the hire-purchase agreement excluded them. The court, however, found a collateral contract between dealer and customer. The consideration was the promise that the car was sound in return for the promise to enter the main contract, or the act of entering it. Such a collateral contract gives rise only to damages, of course. There is no possibility of returning the car since the car was not supplied to the customer by the dealer under the collateral contract.

A further example shows a case in which it was impossible to sue on the main contract, which had not been broken. In *Shanklin Pier v. Detel Products* [1951] 2 KB 854, the owners of a pier had a maintenance contract with a building company, under which the pier owners were to specify materials to be used. They were approached by Detel Products, who said that their paint was good for seven years in outdoor use, so they specified that paint, which proved to be useless. However, the building company could not be sued as they had only done what they were told to do, and any damage was caused by the paint specified and not by faulty workmanship. The court found a collateral contract by Detel Products on which the pier company could sue them for damages.

9.3 Agency

Agency certainly modifies the privity rules, and in cases of undisclosed principals sets the rule aside; *Business Associations* 1.7. Generally, even a person who did not take part in the making of a contract can sue on it if proved to be the principal of one of the persons making the contract.
An agent is able to create a contractual relationship between two other persons, the principal and the third party. Because the contractual liability is that of the principal, generally it does not matter that the agent has no capacity, as long as the principal has full capacity; 11.3.

Agency is a relationship which need not be created by contract, although, especially in business, it often is. However, if a worker, Penny, asks her workmate Adam to go to the shop and buy her a bottle of soft drink, then an agency has arisen. If there is anything wrong with the soft drink, we do not need to worry about the Donoghue v. Stevenson implications (9.1.1), because Penny, who will drink the contents, is the contracting party. Adam can confidently expect to be indemnified for any expenses he reasonably incurs.

Not every person using the name ‘agent’ is, in fact, an agent in this legal sense. Many dealers claim the ‘sole agency’ of certain products. Often all that kind of agency means is an agreement with the manufacturer to import that product. There is no agency. The dealer buys and sells the product as principal, taking a profit for itself. There is only an agency if the agent sells on behalf of the manufacturer (the principal) and holds the proceeds on behalf of the principal, taking merely a commission on sale. Commission is usually a percentage of the selling price.

Agency can be expressly created, and there is no need for any particular form. However, an agent who is to execute a deed on the principal’s behalf must be appointed by deed, called a power of attorney. The Powers of Attorney Ordinance (Cap 31) governs their making and use. They are especially useful to agents, as they give protection to the agent if the agency is revoked without the knowledge of the agent. This is possible on the death or disability of the principal.

Otherwise, an agency may arise by ‘holding out’, where the principal does some act which leads a third party to believe that the agent has authority to make the contract. The whole topic of agency is dealt with in detail in Business Associations, 1.

9.4 Assignment

Assignment provides a mechanism to bypass the doctrine of privity. Assignment may be voluntary or occur by operation of law.
9.4.1 *Assignment by operation of law.* When a person dies, there may be many matters left unfinished, including contracts only partially performed. Two possibilities exist. The contract may be frustrated and all future obligations cease; 6.6. Or rights and duties under the contract may pass to others. If the contract involved performing as a ballerina, death must frustrate it. But if what remains to be done is only paying money or handing over a book, or receiving money for services already rendered, then this can be handled by someone else on behalf of the estate of the dead person. The estate means all the money and possessions, after debts have been paid and before making a division amongst the beneficiaries. The work of administering the estate is done by the personal representative. If there is a will, then that person is called an executor; if none, an administrator.

Something similar occurs on insolvency. For instance, persons who become bankrupt are no longer considered capable of running their monetary affairs. A trustee in bankruptcy is appointed to take over such matters, including performing all contractual obligations which are not personal in nature and bringing in all benefits. This is done for the benefit of the creditors.

9.4.2 *Voluntary assignment.* Like contract generally, this is something which springs from individual decisions and not from the general law. Only the benefit of a contract can be assigned, not the burden. In most contracts, a person gives something to the other side in order to get something back. Thus, where Alice agrees to sell Ben a watch for $400, then Alice’s benefit is the money and her burden the handing over of the watch. Ben’s benefit is the receipt of the watch and his burden the handing over of the money. If you understand the concept of consideration, it is really not too difficult to grasp benefit and burden.

When it comes to assignment, we can see that Alice could assign the right to receive the money, and Ben could assign the right to receive the watch.

If Alice had agreed to mend the watch, then the question of assignment by Ben might have been more difficult. Benefits which are personal in nature cannot be assigned, and it would be a question for the court to decide as to the degree of personal involvement in the mending.

Certain other assignments are not possible. It is against public policy to allow people in positions of public importance to assign their salaries, and a wife’s maintenance cannot be assigned.
Once a contract is made, each party always remains liable to the other party for the proper performance of it. However, vicarious performance allows for the burden of the contract to be shouldered by another as far as actually doing the work is concerned, although responsibility rests on the original contracting party. This lies behind the patterns of contractual responsibility we see in subcontracting, which is not assignment, because the original parties remain bound to each other; 9.1.

Novation releases the original parties, but this is still not assignment. What happens is that Benny and Ann release each other, whilst Celia undertakes the liability that was Ann’s. Ann has no further responsibility to Benny. However, this is not assignment. It comprises mutual release of the old contract by Benny and Ann, and at the same time a new contract is formed between Celia and Benny. This is not assignment, because Benny’s co-operation was essential. In assignment he would merely have been informed of the new position.

Apart from those benefits which cannot be transferred because of public policy, it is possible to assign all benefits under a contract. This provides a genuine exception to the rule of privity. Assignment was not allowed by the common law and was first a creation of equity. Legal assignments are now possible under Law Amendment and Reform (Consolidation) Ordinance (Cap 23) s9, which works like this:

Suppose that Xu owes $10,000 to Yan. Moreover, Zee owes $10,000 to Xu. Would it not be more convenient for Xu to be able to tell Yan to collect the money from Zee? This means the sum of money only has to move once. It is not so advantageous today but you can imagine how useful it would have been to the parties in the days when actual precious metal had to be moved, and it becomes more useful if you imagine that Xu is in a different country from Yan and Zee. Whilst this could still be done by a simple assignment of the debt, this need led to the development of negotiable instruments, described in detail in Cheques.

Before continuing to describe the process of assignment, we need to introduce one more concept. Property can be divided into various categories, and the chose, or thing, in action is one such category. ‘Chose’ is simply French for ‘thing’ and the English word will be used from now on. You are reading this book now. If you bought it, it belongs to you. It is a thing in possession. If you have
made a contract to buy a television set, but the set has not yet been delivered, then your right to the television set is still a thing in action. Any benefit under a contract is a thing in action, which means you would need to take court action to assert your rights over the property if it were to be denied to you.

There is usually no problem about ‘assigning’ a thing in possession. You can just hand over the book to me. That is not usually thought of as an assignment. If I pay you for it, that is called ‘sale’; if not, ‘gift’; or, if we swap it for a pen, ‘exchange’ or ‘barter’.

Assignment, then is of things in action. To take matters further, a benefit under a contract is a legal thing in action, but there are also equitable things in action, such as benefits due under a will or a trust. We shall from now on simplify matters by concentrating on one type of legal thing in action, a sum of money due under a contract, and discuss its assignment both legal and equitable.

9.4.3 *Legal assignment*. Because assignment was seen as desirable, but was not possible at common law, legislation provided the machinery to do it in a way that common law would recognize. The problem with equitable assignment was — and is — that equity cannot give assignees the right to sue in their own names. Law Amendment and Reform (Consolidation) Ordinance (Cap 23) s9 provides the method. The assignment allows the assignor to pass full rights to the assignee against the debtor where the three major requirements of s9 are fulfilled. The assignment must be:
   — in writing and signed by the assignor;
   — absolute;
   — notified in writing to the debtor.

The first and third requirements present few problems. Writing is required, but no special form need be used. As to the notice, not only is no particular form required, but also no requirement is laid down as to who should give the notice. As the assignee will be most prejudiced by lack of notice, it makes sense for that person either to give the notice or to check that the assignor has done so.

However, there is some complex case law on the question of when an assignment is absolute. It is clear that an assignment is not absolute when it is of part of a debt only. Thus, if Alex owes $100 to Barbara, an assignment of $80 dollars out of the debt cannot be absolute.
This is not too difficult for anyone to follow. However, an assignment is absolute when it conveys the full interest for the time being of the assignor to the assignee. Suppose that a building company wants to borrow money. It has the prospect of several payments from contracts falling due over the next year or so, but it requires money now. It could make an arrangement with a bank to advance sums of money to it, allowing the bank to reimburse itself from the building contract payments as they come in. However, the building company does not want to pay the bank too much, and this presents problems in the way of making an assignment. The correct solution was arrived at in *Tancred v. Delagoa Bay & East Africa Railway Co.* (1889) 23 QBD 239. The creditor was given absolute rights to the funds as they came in, but with a provision that there must be a reassignment when payment was satisfied. This was held to be absolute, simply because the need for reassignment confirmed that the assignment had been absolute for the time being.

If the rights are given in the form of a charge over the fund, that is not an absolute assignment. In *Jones v. Humphreys* [1902] 1 KB 10, a schoolmaster attempted to assign his salary to a moneylender. That was held not to be a statutory assignment because only a charge had been created over the money. The right to the salary had not been transferred outright.

9.4.4 *Equitable assignment.* Where possible, people will prefer to make an assignment at law. Equitable assignments are not usually made deliberately. However, an assignment which fails to be legal may be effective as an equitable assignment. The disadvantage, as mentioned earlier, is that the assignee cannot sue without joining the assignor as co-plaintiff or (if unwilling to help) as co-defendant.

Equity requires an intention to assign (which depends on the circumstances of each individual case) and either a perfect gift (that is an out-and-out transfer) or consideration for the promise to transfer. In the case of a thing in possession, a perfect gift passes title without any need for consideration. If Au promises Chan his watch for no payment, then it is clear that, if he does not keep his promise, there is nothing to be done because there is no consideration. If Au actually gives it to Chan, then the gift is perfected and in normal circumstances Au cannot get the watch back. Where the property is a thing in action the matter is more complex. The gift is perfect when the assignor has done all that is possible to pass the property to
the assignee. If the assignment was conditional or by way of charge only, then the gift is not perfect, and consideration will be needed.

The assignment may be oral (as long as there is sufficient evidence of the intention to assign) and any notice to the debtor may be oral. Though notice is not needed to create an equitable assignment, it is advisable. One reason is to gain priority. If the same debt (or parts of it) have been assigned several times, then priority must be established. If there are several assignments, then later assignees in the priority list may get nothing. Priority is decided under the rule in *Dearle v. Hall* (1828) 38 ER 475: assignments take priority in the order that notice was received by the debtor, except that no assignee can gain priority over an earlier assignment if the assignee knew of it at the time of taking the assignment.

Receipt of notice prevents the creation of new equities; 9.4.5. Moreover, a debtor who has no notice of an assignment, may pay to the assignor, get a good receipt, and owe nothing to the assignee.

9.4.5 Equities. All assignments are subject to equities. This is something of an unfortunate name, for it does not really refer to equity in the same sense as we have just used it. Legal assignments are subject to equities in the same way as equitable assignments. Equities in this sense are any defences and counterclaims which the debtor could have raised against the assignor. These can be raised against the assignee. But the receipt of notice by the debtor serves to prevent the creation of new equities. The claims may be based on breach of contract, or, for example, on misrepresentation or mistake. Set-offs and counterclaims also apply. A set-off is a sum of money, often arising from a previous dealing, which is owed to the debtor by the assignor. The debtor cannot be deprived of the chance to make payment less the sum owed by the assignor just because of an assignment to the assignee. Otherwise, assignment could become a way to evade such set-offs. However, it is fair enough to require the debtor to create no new set-offs after the notice.

9.4.6 Negotiability. Assignment is a useful way to ignore the problems posed by the doctrine of privity. The advantages are many, particularly of a legal assignment. The assignee in a legal assignment is able to sue the debtor directly. Assignment also has some drawbacks. It is not possible to transfer free from equities, and there is the problem of notice to the debtor.
A negotiable instrument improves on the advantages of assignment. The best known example is the cheque, which is a form of bill of exchange, itself one kind of negotiable instrument. A negotiable instrument can be transferred by simply handing it over (if it is made out to bearer), or by transfer plus indorsement (which means signing of the name of the person previously entitled). There is no requirement of notice. In most circumstances, a negotiable instrument can be transferred so as to give the transferee a perfect title, even if the transferor’s title was flawed. This means that there can be freedom from equities, which is not possible in the case of assignment. Negotiability is dealt with in detail in *Cheques*.

**Points to Note**

1. Only a party to a contract can sue or be sued on it.

2. A buyer cannot usually sue a manufacturer in contract, nor an employer sue a subcontractor, though there may be an action in tort.

3. Third parties cannot sue on a contract made for their benefit, unless granted that right by legislation; or they sue on a covenant running with land; or through agency; or under a trust.

4. Third parties cannot be sued except through agency or on a covenant running with land.

5. The court may find there is a collateral contract with a third party.

6. An agent may bring the principal into contractual relations with the other party, without the agent being a party.

7. A power of attorney is an agency created by deed. It is necessary if the agent is required to sign a deed on behalf of the principal.

8. Rights (but not liabilities) under a contract can be assigned either in equity or under the Law Amendment and Reform (Consolidation) Ordinance and may pass by involuntary assignment on death or insolvency.

9. The Ordinance requires a legal assignment to be in writing, signed by the assignor, notified in writing to the debtor, and absolute.
10. An assignment of part of a debt is not absolute.

11. An assignment by way of a charge is not absolute.

12. An assignment which fails to satisfy the Ordinance may be effective in equity.

13. The assignee under an equitable assignment cannot sue on the contract without joining the assignor as a party.

14. Equity requires an intention to assign plus either an out and out transfer or a promise to transfer supported by consideration. Notice is unnecessary but has two advantages: it tells the debtor not to pay the assignor and it fixes the priority of the assignment.

15. Equitable assignments rank in priority according to when the debtor received notice of them, except that assignees cannot gain priority over assignments of which they knew when they took their assignment.

16. All assignments are subject to equities.

17. A negotiable instrument can be assigned by transfer (plus indorsement if it is not a bearer instrument). A holder in due course can take free of equities.
10.1 Introduction

Contracts are an important area of private law (see Chapters 1 and 2) and we have seen how they are made (in Chapter 3). However, contracts do not exist in a vacuum. The people who make them are citizens and subject to the laws of the place in which they live. Hence the concept of the illegal contract. But the word ‘illegal’ must not be misunderstood. It does not necessarily mean ‘criminal’. The most extreme example of an illegal contract is a contract to do a criminal act, but milder areas of illegality do exist; 10.2. Once a court recognizes that a contract is illegal, it will not enforce it. Whether criminal proceedings are taken is another matter entirely and, in many cases of illegal contracts, there is no criminal liability on either party.

10.2 The Scope of Illegality

One problem facing students beginning the study of illegal contracts is the number of different pairs of concepts which must be borne in mind. We shall look quickly at what the concepts are, and then look at them in detail in the following sections. A contract can be illegal under the provisions of an Ordinance or under the common law. A contract can be illegal as formed or as performed. A contract can be strictly illegal or void for public policy. The illegality may be one-sided or two-sided.

In dealing with illegal contracts, we need to look at all these pairs. A contract may be strictly illegal, as formed, by ordinance, and illegal on both sides. For example, a contract to avoid paying duty on goods imported into Hong Kong. It may be illegal at common law as performed by one party. For example, a contract to hire a car, where the hirer, but not the owner, knows it will be used
in a bank robbery. It may be illegal by ordinance, with the rights of one party being protected so that the illegality is one sided. For instance, if legislation is passed to protect tenants, then a breach of the legislation by both parties for the benefit of the landlord would be treated as illegal only on the landlord’s side, because the purpose of the ordinance is to protect the tenant. The tenant may have agreed to disadvantageous and illegal terms only because that was the only way to get possession of the premises.

10.3 Illegal by Ordinance

A contract may be illegal under the provisions of an ordinance. This is simply a matter of reading the relevant legislation to be sure. Most of this kind of illegality is about licences. It is forbidden to drive a car unless one holds the relevant licences, and it is forbidden to be a hawker unless one holds the relevant permit.

A problem which arises here, is that the ordinance may provide a fine for the wrongful behaviour but it may not explicitly say what is to happen to contracts made in the circumstances. This does not mean that the contract is invalid. The court must try to discover what the legislation requires, what ‘mischief’ it was passed to prevent. In cases concerning licences, it depends on the purpose of the licence. In *Archbolds v. Spangletts* [1961] 1 QB 374 that purpose was to promote the efficiency of road haulage. The test was ‘does it further the objects of the legislation to declare the contract void?’ If not, the lack of a licence will not affect its validity.

10.4 Illegal as Formed or Performed

A contract can be illegal as formed or as performed. If a contract is illegal as formed, then its whole purpose is illegal, and the consideration (the exchange of promises) is illegal. Thus, a contract to smuggle gold out of the country in a hired car would be illegal in its very inception. But a contract to hire a car which the hirer intended to put to the use of smuggling gold out of the country would not be illegal as formed, since a contract to hire a car is not in itself illegal. It would only be illegal as performed by the hirer, so long as the owner remained in ignorance of the wrongful purpose.
The practical difference is that, in the second case but not the first, the owner could claim the hiring fee. You will see that this is also a case where the illegality is on one side only; 10.5.2 and 10.8.

10.5 Illegality and Public Policy

The illegality of a contract is for convenience divided into two categories. Contracts which are strictly illegal are more severely dealt with than those which are merely void for public policy. These are common law divisions but contracts affected by legislation fall into these categories also.

10.5.1 Contracts strictly illegal. Contracts strictly illegal include those to commit a crime, or a tort, or any fraud on a third person. Contracts to defraud the revenue and those leading to corruption in public life are illegal under the common law, although in Hong Kong we must also look at Prevention of Bribery Ordinance (Cap 201). It is illegal to agree to ‘stifle a prosecution’. This is because the criminal process must not be ‘bought off’. But a private criminal prosecution may be ended by agreement if it concerns only the two parties and does not touch on public safety, for example a prosecution for breach of copyright. Contracts for sexual services are illegal. Oddly enough, if the services are in the past, the objection is simply made on the basis of past consideration and not illegality; 3.7.3. Thus, if payment for past sexual services is promised in a deed (which needs no consideration) the court will enforce payment. Something worth knowing by all discarded mistresses and gigolos. Finally, any contract prejudicial to public safety is illegal. Examples are trading with the enemy in time of war, a contract which would violate the law of a friendly foreign nation.

10.5.2 The court refuses to recognize the contract. The court is not finding in favour of the party in breach by refusing to order payment for work performed by the other in a strictly illegal contract. The court is merely refusing to intervene at all. The court refuses to enforce the contract in any way: no action for the price, no damages, and of course no equitable intervention. One apparent exception is where the contract is illegal on one side only. Then a party who is not guilty of illegality can, for instance, sue for the price. Perhaps the
contract is only illegal because of one side’s acts (as in our example above of the innocent car hire firm). The hiring charges can be obtained. However, it is not easy to argue that a contract affected by illegality is only illegal on one side. In *Pearce v. Brooks* (1886) 1 Exch 213, a carriage manufacturer was not allowed to claim the price from a prostitute who had ordered a carriage. She was a notorious woman, and the carriage maker could not have been ignorant of the fact that she intended to use the fancy, specially built, carriage to attract attention in the exercise of her occupation.

Courts in England have recognized the human needs of prostitutes and have allowed an action for the price of necessities to one who supplies them. But in *The Ki Hing Lau v. The Shun Loong Lee Firm* (1910) 5 HKLR 83, the court had to consider a claim for the price of shark’s fin soup delivered to a brothel, and came to the conclusion that, whereas the consumption of the soup was in itself not objectionable, the effect was to enhance the attractions of the premises and so the contract was illegal. Prostitutes need to eat to live but brothels do not need to survive.

10.5.3 **Collateral contracts.** Where a contract is strictly illegal, there is very little chance of separating the good from the bad. Illegality taints the whole contract. It even makes illegal a collateral contract unobjectionable in itself. In *Fisher v. Bridges* (1854) 3 E & B 642, an illegal contract was made, and the parties (realizing their sale of land was an illegal lottery) put into a deed the promise of one party to pay money to another. Now a deed does not require consideration, so there was no illegal consideration nor was there any objection of want of consideration. But the court traced the transaction back to the main contract and declared it illegal. Exceptionally, a collateral contract was allowed to stand where it consisted of a promise to ensure that the main contract was free from illegality. In *Strongman v. Sincock* [1955] 2 QB 525, an architect, developing his own property, promised the builder he employed that he would see to all the necessary licences. He did not — and refused to pay the builder on the grounds of illegality. The court agreed that the builder could not claim on the main contract which was clearly illegal but allowed him to claim on a collateral contract under which the architect promised to get the licences. It is normally the architect’s responsibility to get licences. If that had not been so, the case might have gone the other way.
10.5.4 No return of money paid. Not only will the court refuse to order payment of the price or damages, it will not order return of money paid or goods handed over under an illegal contract, even where the recipient has not performed the contract at all. In *Yim Wai-tsang v. Lee Yuk-har* [1973] HKLR 1, the court refused to order a loan association to give back money to a member. The claim was perfectly proper within the rules of the association. The problem was that the association had not been registered and was thus illegal. The parties were regarded as all equally to blame. But the result was different in *Chan Ting-lai v. Same Fair Co.* [1986] HKCL 922. A dealer in commodities had not registered under the relevant legislation. It was held that the purpose of the legislation was to protect the public, and so, even though the plaintiff knew the dealer was unregistered, he was allowed to succeed in a claim for money back. The reason was that he was part of a protected class; 10.3.

10.5.5 The repentant plaintiff. The plaintiff who shows ‘repentance’ may be able to get back money paid or property transferred. Repentance means a realization and rejection of wrongdoing. The problem is to distinguish the person who is truly sorry for having done wrong from the person who is only sorry that the contract has gone wrong. In *Bigos v. Bousted* [1951] 1 All ER 92 the court declared that the plaintiff’s repentance for breaking exchange control regulations came into the second category. At that time, British people going abroad were limited in the amount of money they could take out of the country. The plaintiff’s daughter was sick, and the doctor had said that only a warm climate could help her. The plaintiff sent her to Italy and enlisted the defendant’s help to get illegal currency to her, paying the defendant in share certificates. The deal did not go ahead, and the father declared his repentance and asked for the share certificates back. The Court decided his repentance was ‘but want of power to sin’ and sent him away empty handed.

10.5.6 Recovery without the contract. A party to an illegal contract may get property back without relying on the contract. In *Bowmakers v. Barnet Instruments* [1945] KB 65 the plaintiffs entered into illegal contracts of hire purchase with the defendants. The defendants defaulted and if the contract had been legal, the plaintiffs would have been justified in repossessing the goods. The plaintiffs did not rely on the illegal contracts but sued as owners for the return of the goods and recovered them in tort, not contract.
10.6 Public Policy

Contracts may be void because they are against public policy even though not illegal. The courts, whilst disapproving of them, do not regard them with the same severity as those which are strictly illegal. Public policy renders a contract void which attempts to oust the court’s jurisdiction. A clause stating that the courts shall have no jurisdiction over the contract is void. Remember the gentlemen’s agreement; 3.1.4. Where there is no intention to create legal relations, there is no contract. If there is no contract, the courts cannot intervene at all. What is impossible, though, is to give with one hand and to take away with the other! You cannot make a binding contract and say the courts have no jurisdiction over it. Arbitration clauses, if properly drafted, are now made valid by legislation; 7.1.4.

Contracts derogatory to the state of marriage and the family are also against public policy, since the state sets great store by the family unit as the basis of society. The courts will not recognize a contract giving parental rights to another; adoption is not a matter of contract, but of court orders. People cannot by contract bind themselves not to marry though it is possible to arrange to support someone only while they are single. Restraints of trade are against public policy; 10.7.

10.6.1 The effects of a contract void as against public policy. Hermann v. Charlesworth [1905] 2 KB 123 held that a marriage brokage contract was against public policy. Unlike strictly illegal contracts, money paid and property transferred could be recovered.

10.6.2 Severable offending parts. If merely one clause is void as against public policy, that clause may be severed, that is cut out, leaving the contract to stand without it, for example, a clause ousting the jurisdiction of the courts. Collateral contracts will be valid as long as they do not owe their existence only to the void part of the contract.

10.7 Restraint of Trade

The most important kind of contract against public policy is the contract in restraint of trade. Well-known types are those which
restrain an employee from leaving and competing with an employer; sales of goodwill; and solus agreements.

10.7.1 Restraints on employees. An employee may promise in the contract of service not to compete with the employer after the term of service ends. Such a clause is prima facie void, that is it is presumed to be against public policy unless the employer can prove it is in the interest of both parties. Even then the employee may prove that the clause is void because it is not in the interests of the public.

The employer can only establish that a clause is in the interests of the parties by showing that the employer had a genuine interest to protect. This means that the employee was in a position to exploit trade secrets or the employer’s list of customers. It would be harder to justify using such a clause against amahs and office boys than against industrial chemists or sales managers.

Having proved that, the employer then must prove that the clause is no wider than necessary to protect that interest. The geographical area of Hong Kong is small and so English precedents do not help much. It was held in Susan Buchanan v. Janesville [1981] HKLR 700 that a clause in a hairstylist’s contract was void. It tried to prevent her, for a period of one year after leaving the salon on Hong Kong side, from taking up employment as a hairdresser ‘in the Colony’. That meant she could not practise her profession at all without leaving Hong Kong. The Court of Appeal did not object to the time limit, but refused to enforce the clause to stop her from working as a hairdresser in Tsim Sha Tsui.

The court will not redraft the clause. It can only sever the offensive part. It is not enough merely to prove that what is left makes grammatical sense. It must be proved that what is left makes sense in terms of the promise. In Attwood v. Lamont [1920] 3 KB 571, the head tailor in the cutting room of the employer’s firm agreed not to work at a long list of activities in the clothing trade, including tailor, dressmaker, general draper, milliner and haddasher. The court approved time and area, but found the list of activities too wide. They refused to sever any part of the list, and refused to enforce that restraint of trade clause at all.

10.7.2 Protecting goodwill. Another restraint of trade clause frequently found prevents the seller of a business from setting up in competition against the buyer within a certain time and area. This clause is
needed to protect the purchase of ‘goodwill’. ‘Goodwill’ can be much more valuable than shop or office premises and the stock. It is the probability that customers will come back to the place and company they know.

A seller who could not make a binding promise not to set up in competition would have no goodwill to sell. The courts for this reason are readily persuaded of the validity of such a clause and will find reasons to sever any excess. In *Goldsoll v. Goldman* [1915] 1 Ch 292, on the sale of an imitation jewellery business, the seller promised not to compete in ‘real or imitation’ jewellery for a certain time in certain areas. The court severed ‘real or’.

### 10.7.3 Solus agreements

By solus agreements, suppliers give some kind of advantage, often a loan, to outlets (such as pubs or garages) in return for promises to sell only the supplier’s beer or petrol. Such cases are easily proved valid nowadays, if the restraint seems fair in the circumstances, compared with the advantage given. Perhaps all that needs to be stressed is that, unlike other trading contracts, solus agreements may be found invalid if the restraint is excessive.

### 10.8 One-sided or Two-sided Illegality

Illegality (whether of the strictly illegal or void for public policy type) may be one-sided or two-sided. When a contract is only illegal as performed, the illegal performance is often only known to and intended by one party, and the other (so long as it neither knows of the illegality nor should have known of it) may enforce the contract in the normal way; 10.4. Illegality can also be one-sided in exceptional cases where both parties know about and intend the illegality, but one party is a member of a class protected by the legislation; 10.5.4.

### Points to Note

1. The court will not enforce an illegal contract.

2. A contract may be illegal at common law or be made so by legislation.
3. A contract may be illegal as formed or only as performed.

4. A contract may be void because it is against public policy.

5. Illegality may be on both sides or on one side only.

6. The legislation which makes a contract illegal may say expressly that it is void, or that it is valid notwithstanding the illegality, or may make no express provision for the effect of the illegality.

7. If no express provision is made, the contract will not be void unless to declare it so would further the objects of the ordinance.

8. A contract may also be illegal at common law, if it is to commit a crime or a fraud or other tort, or to defraud the revenue, or would lead to corruption in public life or sexual immorality or to stifling a prosecution, or prejudicial to public safety.

9. If the contract is illegal as formed, neither party can sue on it.

10. If only illegal as performed by one party, the other may sue on it.

11. A collateral contract may be affected by the illegality of the main contract.

12. The Court will not only refuse to award damages or the price, or any equitable remedy, it will not order the return of money paid or property transferred under an illegal contract.

13. A repentant party may be able to recover money or property.

14. A party may recover if it is not necessary to rely on the illegal contract.

15. A contract is against public policy if it attempts to oust the Court’s jurisdiction; or is derogatory to the status of marriage or the family; or is in unreasonable restraint of trade.

16. Money paid or property transferred under a contract void as against public policy can be recovered.
17. A clause which is against public policy, in a contract otherwise acceptable, may be severed.

18. A promise by an employee not to compete is presumed to be against public policy unless the employer can show it is in the interests of both parties and the employee cannot prove that it is against the public interest.

19. A clause protecting goodwill on the sale of a business may be in unreasonable restraint of trade and the offending part may be severed.

20. Solus agreements may be in restraint of trade if their terms are unreasonable.
11.1 Deeds

A contract may be made by a deed. It is then called a specialty contract. Note: specialty not speciality. A deed is a document which takes its effect from its formal nature. The formal requirements are a written document executed as a deed, that is signed, sealed and delivered. The party bound by the deed must sign it. The signature must be witnessed. A seal must be affixed. That used to mean that a blob of sealing wax was heated and dropped on to the deed near to the signature and the seal (or chop) of the signer was impressed into the wax before it cooled. Now a little disc of red adhesive paper is used, or a company seal is impressed with a stamp, or it is even sufficient to show where the seal is by writing the letters LS, the initials for locus sigilli, the place of the seal, and drawing a circle round them.

Few documents need to be made by deed. One is a transfer of land. Another is the creation of a power of attorney, where the attorney is given power to create a deed. You note that neither is a contract. You have seen also that a promise made by deed is binding, even though no consideration is given for it, 2.2, but that in such a case the court will not enforce it by specific performance; 7.4.1.

11.2 Written Evidence

In general a contract, whatever its purpose, may be proved by oral evidence. One kind of contract, however, is required by legislation to be supported by written evidence. Conveyancing and Property Ordinance (Cap 219) s3 provides:

No action shall be brought upon any contract for the sale or other disposition of land or any interest in land,
unless the agreement upon which such action is brought, or some memorandum or note thereof, is in writing and signed by the party to be charged or by some person thereunto by him lawfully authorized.

This means that the courts will not enforce a contract for the sale or other disposition of land, or an interest in land, unless there is written evidence to satisfy the Ordinance. However, one of equity’s creations is preserved by s3. If the party seeking to prove the oral contract can show part performance, that will be an adequate substitute for written evidence.

11.2.1 What s3 requires? The contract need not be in writing. What s3 demands is written evidence of the contract. It does not matter what form the written note or memorandum takes, or whether it is contained in more than one document, if the documents can be seen to refer to one another. But s3 requires the written material to contain:

1. The signature of the party to be charged or authorized agent. The party to be charged is the party who is denying the existence of the contract. There is no need for it to be signed by the party trying to enforce the contract.
2. The names of the parties or sufficient description to identify them.
3. A sufficient description of the subject matter, for example, the address of the land sold.
4. Written evidence of the price or other consideration.
5. All the material terms. Whether or not a term is material depends on the intentions of the parties, to be discovered from all the evidence. But a term included for the benefit of one party only may be waived.

11.2.2 Part performance. The court will not accept part performance as a substitute for written evidence unless the plaintiff can prove the following:

1. That the act of part performance was done by the plaintiff, the person seeking to enforce the contract.
2. That the contract was specifically enforceable.
3. That there was sufficient oral evidence of the contract.
4. That the act of part performance makes it inequitable on the defendant’s part to rely on the lack of written evidence as a defence.
(5) That the act was not equivocal; that is, it must look like an act of part performance and nothing else. It is enough if the obvious explanation of the act is that it was done, not necessarily in performance of, but with reference to the oral contract. In *Broughton v. Snook* (1838) Ch 505 A agreed orally to buy B’s inn, which was then tenanted. Two months before the tenancy was due to end, A, with the tenant’s permission and B’s knowledge, paid for certain alterations and repairs. He pleaded this act as part performance of the contract to buy when B pleaded that there was no written evidence. B said that the payment was equivocal, in that A might have made it because he had taken over the last two months of the lease from the tenant. The court held that there was a sufficient act of part performance, even though ‘an ingenious mind might suggest some other and improbable explanation of the facts’. It is not usually, though not never, enough to make a payment of money, for that is referable to so many things. Moreover, if the money is repaid, it would not normally be inequitable to rely on the statute.

It appears that the only remedy the court can grant is specific performance of the contract, so that if that remedy is for some reason unavailable to the plaintiff, part performance is of no avail. This happens where the plaintiff is an infant. Equity demands mutuality, and as a decree of specific performance will not be made against, it will not be made in favour of an infant; 7.4.1 and 11.2.

11.2.3 *The effect of the lack of written evidence.* If there is no written evidence, s3 says that the contract is unenforceable, that no action shall be brought upon it. The contract is not void or voidable, it is binding, but neither party can sue on it. This may be as bad for a party as if the contract were void, but sometimes the party injured may not be deprived of satisfaction. First, the judge will not require written evidence unless the defendant pleads s3; that is, unless s3 is mentioned, the court will pretend that it does not exist. Secondly, it is possible for the party not in breach to keep money paid under the contract by the party in breach, for example, where a party has paid a deposit under an oral contract for the purchase of land and then refuses to complete. The vendor, though unable to make the purchaser complete the purchase, can keep the deposit. This may often be enough to persuade the purchaser to complete the purchase.
Moreover, there is no need for the written evidence to exist at the time the contract was made. It may be any written evidence which the plaintiff manages to get hold of before the action is heard. In *Farr, Smith & Co. v. Messers* [1928] 1 KB 397, A sued B upon an agreement required to be evidenced in writing. A had no written evidence. B in his statement of defence denied that he was bound in contract to A, but set out the terms of the agreement the subject of dispute, which he said was not with A but with A Ltd. A asked the court for permission to have their names struck out of the action and replaced by A Ltd. This was done and B’s defence in the first action was held sufficient evidence of A Ltd.’s contract with B.

11.3 Capacity

In *Printing and Numerical v. Sampson* (1875)19 Eq 462, Sir George Jessel M.R. said:

> If there is one thing more than another which public policy requires, it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by courts of justice.

The policy of the law at its formative period was to give the utmost freedom of contract. Such a policy was demanded by the growth of trade and industry. The new power of the merchant class changed many of the privileges which had been built into the law to protect the landowners, the powerful class of feudal times. One restraint on freedom of contract was, however, retained and enlarged. Freedom of contract might mean freedom to exploit economic power, but the objects of this exploitation must be men of full age and competent understanding. Therefore, there had to be protection, at common law and later by statute, of infants, that is persons of less than 21 years of age. The common law also protected lunatics, as they were then called, and drunkards.

At one time it was thought useful to protect married women’s property from the depredations of spendthrift husbands; society has so changed that the law on this recondite matter is now obsolete.
Moreover, the tool of capitalist expansion, the limited company, had also to be cherished, and the investments of speculators and trade creditors safeguarded from rash promoters and operators. It seemed proper to restrict the powers of the company so that it might make only such contracts as were within its stated objects.

11.3.1 *Infants.* In Hong Kong the age of contractual capacity is 18; Interpretation and General Clauses Ordinance (Cap 1) s3 as amended by Age of Majority Ordinance (Cap 32) 1990. The policy of the common law was to protect infants from the inferior bargaining position which might be expected to result from their inexperience. It may well be that small children would not be held to a contract because they have no mental ability to agree, though the cases are silent on this point. It is also important to remember that parents are not liable on contracts made by their infant children unless it can be proved that the child was acting as the parent’s agent.

The 1990 Ordinance s18 has removed the anomaly by which infancy was not a defence in the District Court. By s4 the court may order the infant to give back any property acquired under an unenforceable contract; and s3 makes a guarantee of an infant’s unenforceable contract binding on the guarantor.

11.3.2 *Necessaries.* A person who lacks contractual capacity may have to pay a reasonable price for ‘necessaries’ — not ‘necessities’, for that has a different meaning. SOGO s4 provides:

Where necessaries are sold and delivered to an infant or minor, or to a person who, by reason of mental incapacity or drunkenness, is incompetent to contract, he must pay a reasonable price therefor.

‘Necessaries’ are goods suitable to the infant’s ‘condition in life’, which means the style in which he or she has been brought up to live, and to actual requirements at the time of sale. Though SOGO does not say so, ‘necessary’ services are treated in the same way as ‘necessary’ goods.

If the supplier can prove the goods or services are necessaries, a reasonable price — not the contract price — can be recovered. The claim is not in contract but in quasi-contract; 7.6. The goods must be sold and delivered. An executory contract for goods cannot be
enforced against an infant, though there is English authority, of doubtful weight, that executory contracts for necessary services can be. The policy of the law is that even those suffering from incapacity should be able to get what the law considers they need — on credit. Therefore, shopkeepers must be given an action for a reasonable price.

Sales of necessaries to mentally disordered or drunken or drugged persons are treated by SOGO in the same way as sales to infants.

11.3.3 Non-necessaries. Contracts for things which are not necessaries are voidable by the infant (or mentally disordered or drunken or drugged person). Ordinary trading contracts are always voidable by infants. Contracts which confer a lasting benefit on infants start off voidable but become binding if the infants do not avoid them before they reach 21 or within a reasonable time thereafter. Such contracts cannot be accurately defined but the courts have held that they include contracts concerning land, or partnerships or shares in a company.

11.3.4 Other remedies. Infants may be sued in tort but not if that would just be another way of enforcing a contract claim to which the infant could plead incapacity.

11.3.5 Women. There are no distinctions in the law of contract now between women and men.

11.3.6 Corporations. Corporations, particularly limited companies, are legal persons. They have whatever rights and capacities are given to them by legislation, for example, their memorandum of association, or by royal charter. Their capacity is a matter of company law; Business Associations, 3.

11.3.7 Mentally ill and drunken or drugged people. Where an order has been made under Mental Health Ordinance (Cap 136), ss11 to 13, the patient’s contractual capacity is taken away and handled by others. Even without such an order, mentally sick persons, or those intoxicated by alcohol or other drugs at the time of making a contract, can avoid it if it can be shown they did not know what they were doing and the other party should have realized that. They must, however, pay a reasonable price for necessaries delivered; 11.3.2.
Points to Note

1. A contract may be made by deed.

2. A deed must be signed, sealed and delivered.

3. A promise made by deed is binding without consideration.

4. Contracts for the sale or other disposition of an interest in land are unenforceable unless proved by written evidence.

5. The written evidence must contain the signature of the party to be charged; the names or description of the parties; description of the subject matter; the price or other consideration; all the material terms.

6. Part performance is sufficient substitute for written evidence.

7. Part performance requires that: the act was done by the plaintiff; the contract is enforceable by specific performance; there is sufficient oral evidence of the contract; it is inequitable for the defendant to plead the lack of writing; the act was unequivocal.

8. The lack of writing must be pleaded; the court will not raise the objection.

9. The oral contract is not void, and money paid or property transferred can be kept.

10. The written evidence may be obtained at any time before the trial.

11. A person attains capacity to make a contract only when 18 years of age.

12. Infancy is not a defence in the District Court.

13. Even though lacking capacity, a person must pay a reasonable sum for necessaries delivered.

14. A person who is drunk (or drugged) or suffering from mental incapacity lacks contractual capacity if the other party knows of the incapacity.
15. Necessaries are goods and services suitable to the person’s condition in life and actual needs.

16. Contracts for non-necessaries are voidable by a person lacking capacity.

17. Contracts which confer a lasting benefit are binding if not avoided within a reasonable time of gaining capacity.

18. Infants may be sued in tort unless that would amount to forcing a contract on them.

19. A guarantee of an infant's unenforceable contract is binding.

20. An infant may be ordered to give back property acquired under an unenforceable contract.

21. A corporation has capacity to make only those contracts allowed by its memorandum of association.
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