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The Nature of Contract Law in Hong Kong

Overview

Contracts may take a huge variety of forms; from the simplest, small "one-off" transaction like buying a newspaper, to a complicated commercial contract, written in technical language and intended to be of lengthy duration. Nevertheless, the same basic rules as to formation, performance and enforcement apply to all contracts.

The purpose of this chapter is to ask what contract law is, what it does and what, if anything, is unique or special about Hong Kong contract law. In keeping with the largely non-theoretical nature of this book and the constraints of space, the answers to the above questions will be based on traditional notions of contract and more radical formulations will be merely alluded to. This should not be taken as a rejection of more radical views but an assertion that the objective is to reflect how contract law is generally viewed by traditional judges, lawyers and legal writers.

In asking what contract law is, we may begin with the statement that contracts are *legally enforceable agreements*. In defining contract, these two elements: an agreement between the parties, and some form of enforcement thereof, are crucial. We might, perhaps, wish to add another requirement; the agreement should not have been procured by improper means such as threats or dishonesty. We would also wish to qualify the first basic element, since agreement, especially where the parties are of unequal bargaining power, is often more theoretical than real. I may make a contractual "agreement" to travel on a bus every morning but if I dislike the "infotainment" provided or the sub-zero air conditioning I am in a "take it or leave it" situation, unable to vary the conditions of travel or to negotiate a reduced fare for travelling in discomfort. My alternative is to walk or take a taxi!

The notion of "agreement" must also be qualified by saying that whether parties have agreed is usually judged "objectively" rather than "subjectively". This means that what is actually in a party's mind is usually irrelevant; what matters is that a "reasonable person", assessing the party's words and deeds, should conclude that he has "agreed".

Moreover, agreement, while a necessary requirement of contract, is not a sufficient one; many agreements may lack contractual force because of other deficiencies. A particular feature of contract in common law systems, such as Hong Kong

and England, is the requirement of "consideration" which means, essentially, that no one may enforce an agreement unless he has given something of value to the other party to the agreement, either in the form of a "benefit" to that other party or a "detriment" to himself. Further, an agreement may be non-contractual where it is viewed by the courts as a purely social arrangement, never intended to be legally binding. Additionally, a party to an agreement may be found to lack contractual "capacity" because of his youth or other disability; some agreements, such as those concerning the transfer of land, may lack the necessary written formality; and the threats or dishonesty mentioned above may constitute "vitiating" elements sufficient to invalidate the agreement. Nevertheless, despite these additional requirements, *agreement* remains the fundamental basis for contractual liability. Legal obligations may exist in the absence of agreement but they will not be contractual ones.

The element of "enforceability" in contract law also requires qualification in so far as it implies that parties may be required to honour their promises. In fact, actual "enforcement", by an order known as "specific performance", is exceptional and the normal result of the breach of a contractual undertaking by one party is that he is required to pay monetary compensation (damages) to the "innocent" party.

Nonetheless, enforcement, in the sense of being entitled to seek legal redress for breach, is what distinguishes contracts from other, non-binding types of agreement. While parties may seek to avoid litigation, especially where they have dealt with one another over a long period, the importance of the right to seek compensation for breach "as a last resort" is fundamental.

Having outlined what contract is we next need to ask what it "does". In traditional terms, the law of contract put most simply, allows people to make their own contracts with minimal interference and then insists on performance. In theoretical language, these are known as the principles of *freedom* and *sanctity* of contract. "Freedom of contract" denotes that it is for the parties to make their own contracts without the intervention of government, legislation or the courts. "Sanctity of contract" upholds the principle that once agreements are made they should be honoured. Where a contracting party does not honour the agreement, the other party will be entitled to a legal remedy.

Freedom of contract has never been total, either in Hong Kong or England; it has always been recognised, for example, that a contract to do something criminal would be unenforceable. Legislative restrictions on contractual freedom in most common law jurisdictions have, indeed, now become so numerous that many writers regard freedom of contract as of only historical importance. Such restrictions have been engendered primarily by a recognition that the main beneficiaries of complete contractual freedom are the rich and powerful. Legislation has gone some way to redressing the balance, particularly in the areas of consumer protection and employees' rights. Hong Kong governments, however, have had, since colonial times, a barely-concealed "close relationship" with big business, such that legislative intervention into the so-called "free market" has been avoided, where politically possible,

and otherwise delayed. This reluctance to act is exemplified by Hong Kong's inadequate employment protection laws, limited control of anti-competitive practices, and relatively undeveloped consumer protection legislation.

Sanctity of contract, unlike freedom of contract, has remained largely intact in the common law world. It remains the case that, unless the performance of a contract becomes illegal or impossible, full performance, or at least compensation for failure to perform, is required.

1.1 What Contract Is

A contract may be described as a "legally enforceable agreement". That simple statement summarises the rules on contract to be found in the decided cases and the relevant legislation.[1] The element of *agreement* is of crucial importance since, while not all agreements are contracts, all contracts require at least an apparent agreement. Moreover, it is the element of agreement that distinguishes contracts from other forms of obligation, notably tortious ones.

The need for "agreement", however, must be qualified. First, it is clear that in many cases agreement is more apparent than real. The idealised view of agreement involving intense haggling, give and take and ultimate consensus is replaced, in many cases, by something more akin to "take it or leave it". The consumer who buys a new car, signs a contract for electricity supply, or purchases private schooling, is unlikely to have any say in the "form" of the contract. Even the argument that he can go elsewhere if he does not like the terms imposed loses much of its force in those situations where, as in the case of new car sales, "standard" terms are likely to apply wherever the car is purchased. It is in such cases of inequality of bargaining power that legislative and judicial "interference" with the contract is more likely.

It should also be pointed out that "agreement" is judged objectively, thus:

> If, whatever a man's real intention may be, he so conducts himself that a reasonable man would believe that he was assenting to the terms proposed by the other party, and that other party upon that belief enters into the contract with him, the man thus conducting himself would be equally bound as if he had intended to agree to the other party's terms.[2]

So, if A genuinely and reasonably believes that B agrees to his terms, the necessary "agreement" exists, irrespective of B's subjective belief. Suppose, for example, that A advertises an item on the internet and seeks bids. B offers to buy for $10,000 and A immediately accepts. There is the objective appearance of agreement and a court would generally ignore a subsequent claim by B that he was "mistaken" and meant to offer only $1,000. A reasonable person looking at the agreement would say it was a contract to sell for $10,000 and this would be the legal position. A similar

1. For more on the sources of Hong Kong contract law, see chapter 2.
2. Per Blackburn J in *Smith v Hughes* (1871) LR 6 QB 597.

situation arose in *Centrovincial Estates plc v Merchant Investors Insurance Co Ltd*.[3] Here the plaintiffs, in renegotiating a lease, "offered" a rental of £65,000 per year, which the defendants accepted. The plaintiffs pleaded that there was no contract as they had been "mistaken". The previous price was over £68,000 per year in a rising market and the plaintiffs said that they "meant" to state a price of £126,000 per year. The court upheld the figure of £65,000 since it had been clearly expressed in writing and accepted by the other party.

It would have been different if it could have been clearly shown that, in the circumstances of the case, the defendants must have known that the plaintiffs were making a mistake and took advantage of the situation.[4] In the absence of conclusive evidence of such bad faith, however, there was, "objectively", an offer to let at £65,000 per year and an acceptance thereof.[5]

Agreement is generally viewed as comprising two elements: an offer by one party and an acceptance of that offer by the other.[6] There are exceptional cases where contracts have been upheld although agreement, at least in terms of offer and acceptance between the so-called "parties", is difficult to discern. In *Clarke v Dunraven*,[7] the respondent's boat was sunk by the appellant's boat during a sailing race, as a result of the appellant's breach of the race rules. All parties in the race had agreed with the organisers to abide by the rules and, in the event of non-compliance, to pay compensation for any resulting damage. The House of Lords, in upholding the respondent's claim, found that there was a contract between appellant and respondent though neither had made an agreement with the other. Given the absence of a developed tort of negligence at the time this case was decided, the only potential remedy available to the respondent lay in contract[8] and the decision may be viewed as one in which the court did justice by means of extreme "creativity".[9] Certainly the parties were happy to agree to the terms of the race, but it was surely artificial to imply that the plaintiff and defendant had made an "agreement" with each other. Without disapproving this decision, the highest courts have upheld the principle, in contemporary cases, that there should invariably be offer and acceptance as between the parties.[10]

Nor is it always sufficient to focus on the *existence* of an agreement, since the *time* at which the agreement is formed may also be highly significant. Discussion of this question usually focuses on narrow issues of when (or where) a contract made by telephone, email or fax is concluded. While there may be significant jurisdictional

3. [1983] Com LR 158. See also *Tamplin v James* discussed at 10.4.
4. As in *Roberts & Co Ltd v Leicestershire CC* discussed at 10.6.
5. The decision has been criticised: see P. S. Atiyah, "The Hannah Blumenthal & Classical Contract Law", (1986) 102 LQR 363.
6. There must, it is said, be a meeting of minds or *consensus ad idem*.
7. [1897] AC 59.
8. The respondent was entitled to statutory compensation but this was very limited.
9. See 1.2.2.
10. See, for example, *Gibson v Manchester CC* discussed at 3.2.

implications in such cases, the "time of formation" involves far wider issues, since so many of the courts' deliberations are required to focus on the time at which the contract is made. If, for example, one party wishes to rely on an exemption clause[11] in the contract, its existence must have been made known to the other party before the contract was concluded. Moreover, where the "reasonableness" of the exemption is significant, this must be judged as at the time the contract was made. Where a party wishes to escape liability to pay damages for misrepresentation,[12] he must prove a genuine and reasonable belief in the truth of his false statement up to the time when the contract was made. It is not enough that his belief was genuine at the time his statement was made. In those rare cases where common mistake[13] is operative this will require a mistake as to a fundamental state of affairs already existing at the time the contract was made. If a subsequent event fundamentally alters the agreement, it cannot constitute mistake (though it could amount to a "frustration"). The doctrine of frustration itself,[14] which arises where an event occurs after a contract is formed (but before the time for performance) which makes performance impossible, may not be successfully invoked by a party who should have foreseen, at the time the contract was made, the subsequent serious event. In the case of damages,[15] too, the time when the contract was made may be crucial, since the "reasonableness", and hence enforceability, of the pre-estimate of loss in a so-called "liquidated damages" clause is judged as at the time the contract was made, not in light of what actually happened as the result of one party's breach.[16] Moreover, a party in breach will only be liable in damages for consequences which should have been foreseen as likely to result from the breach at the time the contract was made.

In summary, the circumstances existing when the parties *agree* a contract may have profound consequences for the contract later.

While agreement is always necessary, it is not sufficient, in itself, to prove the existence of a contract. Given a clear agreement between the parties, other requirements remain to be fulfilled.

For hundreds of years in England, and throughout Hong Kong's common law history, the further requirement of "consideration"[17] is demanded in all cases of contracts made other than under seal.[18] Thus,

> the growth of the doctrine of consideration as a limitation on what promises will be enforced seems to have been prompted by the adoption in the sixteenth century

11. See 8.6.
12. See chapter 9.
13. See 10.3.2.
14. See 14.4.
15. See 15.1.
16. The civil law approach is different and it appears that English law may be changing in this area (see chapter 15).
17. See chapter 4.
18. This was once a cumbersome procedure involving waxed seals but is now very simple. Indeed, many businesses conclude their agreements under seal to avoid the consideration requirement.

> of a new form of action, the action of assumpsit, to enforce promises. Before that, promises were actionable in the royal courts only if they were part of one of a recognised type of exchange such as a sale, or were made (under seal)[19]

The consideration requirement has proved an extremely elastic one and most of the "rules" of consideration are subject to exception, as we shall see in chapter 4. Where the courts have wanted to enforce an agreement they have normally been able to discover consideration. In short, the requirement of consideration remains but is capable of considerable "adaptation" by the courts where appropriate.

It is also now generally accepted that a contract requires an intention[20] to be bound by both parties. While this proposition is a relatively new one and is not without its critics (notably Professor Williston),[21] the cases indicate that intention must be viewed as a separate, essential element for the formation of a contract, albeit that intention, like agreement, must be judged "objectively".[22]

The agreement on which a contract is based is also subject to the rules of contractual capacity[23] and, exceptionally, to any special requirements as to form.[24] Further, even where a contractual agreement contains all the necessary requirements for its formation there may be some "vitiating" element, such as misrepresentation or mistake, which precludes, in whole or in part, the enforcement of the agreement.[25]

It is "enforceability" which distinguishes contracts from other forms of agreement. Enforceability does not mean that a party in breach can be required to perform his contractual undertaking; such a requirement ("specific performance") by the courts is the exception rather than the rule. What an "innocent" party may always do, however, is obtain compensation for the consequences of the other's breach. Where such breach has caused no loss, the court will award nominal damages in recognition of the breach. Traditionally, via the principle of "sanctity", courts have always enforced contracts whatever the circumstances of the failure to perform. The word "sanctity" implies a moral element, that parties ought to keep their side of the bargain because they have formally promised to do so. Such a moral aspect is now generally rejected in favour of more pragmatic approaches. It would now be more common to view the enforcement of agreements as producing certainty in the market place, or preventing parties taking the law into their own hands. Economic approaches talk in terms of whether it is more "efficient" to perform rather than pay compensation for non-performance and the moral aspect of keeping a promise is rarely expressed. Nevertheless, even with the innovation of "frustration", a limited exception to sanctity introduced in the nineteenth century, courts remain reluctant to

19. Beale, Bishop and Furmston, *Contract Cases and Materials* (Oxford: Oxford University Press, 5th edn, 2007), p 8.
20. See chapter 5.
21. See chapter 5.
22. See, for example, *Jones v Padavatton* [1969] 1 WLR 328, [1969] 2 All ER 616.
23. See chapter 6.
24. See chapter 7.
25. See chapters 9–12.

excuse non-performance. A finding of frustration is exceptional[26] and a party who fails fully to complete his side of the contract is almost invariably liable for breach.

1.1.1 The Boundaries of Contract Law

Before considering the function or purpose of contract law, we will first try to outline what areas a typical contract law text, such as this, will deal with. It might be thought that "contract law" would include study of all types of contract, but this is not the case. Some areas, especially those which are highly specialised or statute-based, are dealt with as separate subjects in their own right. Contracts of employment, for example, are treated, generally, as falling within the scope of "employment law". This has much to do with the fact that legislative rules are far more important in this area than common law[27] contractual principles. When considering the employee's contract of employment, for example, we say that the contract may improve the employee's guaranteed statutory rights but cannot diminish them, irrespective of its express terms. Such a limitation on the parties' "freedom" applies in both England and Hong Kong, though it should be appreciated that the protection of employees' "rights" is far less developed in Hong Kong. Likewise, specialised treatment of "sale of goods" contracts tends to be dealt with in "commercial law", again because the subject is highly statute-based. As a final example, detailed treatment of the sale of land is more likely to occur in the context of "land law" or "real property law"; once again the relevant rules are primarily statutory rather than "common law".

The huge diversity of contract types has led some commentators to say we should talk of a law of "contracts" rather than contract, just as, in respect of non-contractual obligations, we talk of a law of "torts" rather than tort, on the basis that there are few principles common to all torts. The analogy is questionable, however, because, while we can see that there is little similarity between, for example, the torts of negligence and defamation, there are rules common to all contracts. Sale of goods, for example, may be a specialised area, but the more specific rules will not begin to operate unless the basic contractual elements (agreement, consideration and so on) exist. The concept that there are basic rules applicable to all contractual situations was emphasised in the case of *Cehave v Bremer (The Hansa Nord)*[28] where Roskill LJ responded to the argument that there should be a different classification of terms in sale of goods contracts by stating:

26. See, for example, *Davis Contractors Ltd v Fareham UDC* [1956] AC 696, [1956] 3 WLR 37, [1956] 2 All ER 145.
27. While "common law" has various meanings (see chapter 2), in this context it refers to those rules deriving from cases rather than legislation.
28. [1976] QB 44, [1975] 3 WLR 447, [1975] 3 All ER 739.

> Sale of goods is but one branch of the general law of contract. It is desirable that the same legal principles should apply to the law of contract as a whole and that different legal principles should not apply to different branches of that law.[29]

This view lends support to the view that judges should recognise some generally applicable contractual principles. These may be amended, or dispensed with, by legislation but, absent legislation, these general contractual principles will apply.

In short, the focus of this book will be on the general principles applicable in the law of contract. The order of substantive topics will be:

- the necessary elements for the formation of a contract (chapters 3–7);
- the contents, or terms, of a contract (chapter 8);
- "vitiating" elements which make the agreement defective in some way (chapters 9–13);
- how contracts come to an end (termination) (chapter 14); and
- remedies for breach of contract (chapter 15).

The final chapter (chapter 16) is about "privity" of contract, the basis of which is that only parties to the contractual agreement have rights and obligations under it. Since "agreement" is our starting point, privity can be seen as completing the circle.

It may seem odd that, although we will not consider all types of contract in depth, we do find time to consider some overlapping areas of tort law which deal with obligations arising other than through agreement. However, tort is relevant to the study of misrepresentation, for example, since, while misrepresentations "induce" the making of a contract, damages for misrepresentation are tortious. Consideration of these remedies is within the scope of this book since to deal with the meaning of misrepresentation but not its consequences would be artificial. Similar overlaps will be apparent when we deal with attempts to exclude liability in contract and tort and when we look at the difference between the "remoteness" rules in contract and tort. No detailed tort knowledge will be required, however, to understand this text.

The contract law we will examine in this book is built, primarily, on two foundations: the cases, or "precedents", which form its overall framework, and the legislation which has supplemented this case law, or "common law" as it is also known. Since Hong Kong law, post-1997, comprises a unique blend of English common law and legislation, Hong Kong common law and legislation and, to lesser extents, Chinese customary law and legislation, chapter 2 is devoted to the sometimes complex issue of the "sources" of Hong Kong contract law.

1.2 The Function of Contract Law

Some writers draw a distinction between the role of the contract and the role of contract law. The former may often be expressed in quite limited terms, such as

29. [1975] 3 All ER 739 at 756.

"informing" the parties of their respective rights and obligations and assisting their "planning". The focus here will be on the function of contract law; asking what it does and, by implication what would happen if we had no law of contract.

Until comparatively recently the predominant theory of contract could be described as the "will theory"—that the role of the courts was to identify and enforce the contractual will of the parties and to intervene as little as possible in respect of bargains freely made by competent adults. The emphasis has been on contractual "freedom". Freedom of contract remains a dominant principle in the United States where state intervention in the free market is strongly resisted.

More recently, in England and, to a lesser extent, Hong Kong, it has been possible to identify a more "interventionist" approach by legislation and the courts. Such intervention has been broadly "protectionist"—seeking to support the weaker contracting party from the "dominance" of the other, stronger party. This approach can be discerned, legislatively, in the area of employees' rights, consumer protection and anti-discrimination laws. Judicial intervention can be seen in the increasingly restrictive approach to exemption clauses[30] and the expansion of the doctrines of "duress" and "undue influence".[31] Interventionism is based on the premise that complete freedom of contract tends to favour those who have more negotiating power because of their greater resources, contractual experience, access to legal advice and so on.

It is the "balance" between freedom of contract approaches and intervention to assist the weaker party with which we will be chiefly concerned in this chapter.[32]

1.2.1 The Will Theory of Contract

In classical contract theory the role of the courts is to permit, even encourage, free bargaining by competent adults. The function of the court, if called upon, is to discover the true nature of the parties' agreement and, in the case of breach of such agreement, to compensate the innocent party. This theory reached its high point in the highly industrialised, economically dominant England of the nineteenth century. The theory was underpinned by the twin ideals of "freedom of contract" and "sanctity of contract". The notion of freedom of contract is not merely that an agreement is required but that such agreement represents the entire contract; provided the agreement was made freely, the courts and legislature should not intervene. Only in the event of a breach of the agreement should the courts be concerned. A classic definition of the freedom (and sanctity) of contract approach is provided by Jessell MR:

30. See 8.6.
31. See chapter 11.
32. There are, of course, far more radical approaches to contract law, some of which see law in general and contract law in particular in a far less favourable light. Such theoretical approaches are outside the scope of a book of this nature.

> (if) there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts . . . entered into freely and voluntarily shall be held sacred.[33]

There have always been exceptions or qualifications to this theory in its pure form. Courts have always asserted the right to "police" the bargain and a freely-made contract will be invalidated if it is shown to be illegal or induced by one party's fraud. Since the agreement must be a genuine one, the common law has long recognised the vitiating element of duress (the use or threat of physical force) as invalidating a contract if the "victim" so wishes. Given the narrow constraints of traditional duress, equity developed a doctrine of undue influence where

> one party had induced the other to enter into the transaction by actual pressure which equity regarded as improper but which was formerly not thought to amount to duress at common law because no element of violence to the person was involved.[34]

Duress itself has been considerably expanded by a recognition by the courts that it can apply to "economic" as well as physical pressure. Even in the absence of wrongdoing by either party, mistakes of a fundamental nature may render a contract void, though this occurs rarely in practice.

Since it is also implicit that agreements will be enforced only against competent parties, rules on capacity restrict the scope of minors, drunkards and the mentally ill to make enforceable agreements. Further, since corporations can impose their own restraints on their contractual capacity via their memorandum and articles of association, the courts have the power to declare a company's contracts *ultra vires*. However, given that Hong Kong law no longer requires a memorandum of association, this is unlikely to be a problem in practice.

Long before the development of consideration, intention and the various vitiating elements, English law restricted the making of informal contracts by the requirement that certain contracts had to be made under seal, in writing, or via written evidence. The Statute of Frauds, 1677, initially required that various categories of contract had to be evidenced in writing. Most of these formal requirements have now been abolished. However, one important category remains of great significance in Hong Kong: contracts for the sale or other disposition of land, which must be evidenced in writing or supported by an unequivocal act of part performance.[35]

The most significant interference with contractual "freedom", however, arises via the intervention of "implied" terms. Implied terms are regarded as part of the contract even though not expressed by the parties. Such terms may arise through the custom of a particular trade or market, to give "business efficacy" to a contract,

33. Cited in Beale, Bishop, and Furmston (n 18 above), p 47.
34. E. Peel, *Treitel: The Law of Contract* (London: Sweet & Maxwell, 14th edn, 2015), pp 506–507.
35. In England these formal requirements have become more restrictive since the contract must now be written as opposed to evidenced in writing and the (equitable) part-performance doctrine has been abolished.

or where the term is seen as omitted only because it is so obvious it "goes without saying". In all these cases the implied term may be viewed as part of the parties' "real" intention; something they meant to include but did not or, at the very least, something they would have included if they had considered the matter more carefully.

However, the traditional view, that implied terms do not undermine contractual freedom but are merely an expression of the parties' true intention, can no longer be viewed as absolute. Many statutory implied terms are now non-excludable even by the clearest exemption clauses, even if such exemptions have been read, understood and signed by the party seeking to escape the exemption. Such statutory implied terms are legislative consumer protection which owes nothing to the expressed "will" of the parties. While such consumer protection legislation is more widespread in England, the (previously) most important restriction on exemption clauses, the Unfair Contract Terms Act 1977 (now largely superseded by the Consumer Rights Act 2015) has been reproduced with little amendment in Hong Kong via the Control of Exemption Clauses Ordinance (CECO). There are also terms implied "in law" which cannot be said to be based on the parties' presumed intention but are simply required to be present in contracts of a certain type.[36]

It is more common, therefore, to regard "freedom of contract" as a concept steeped in the ideology of nineteenth century "laissez-faire" industrial England and long abandoned in favour of more "protectionist" judicial and statutory intervention. Increased intervention, in England, would be seen as a natural consequence of a move from a free market economy to a more welfare-based society.[37] The interventionist trend appears to have continued despite over 20 years of Conservative and "new right" Labour government. Freedom of contract still has its adherents, however, especially in the still-significant economy of the United States. The American view remains that intervention into the contractual agreements of individual, cognisant adults should be exceptional and restricted. It might be assumed that Hong Kong's less welfare-oriented political system would be reflected in a free-market, non-interventionist approach to contract but this is not entirely the case.

1.2.1.1 Legislative Restraints on Freedom of Contract in Hong Kong

Despite the growth of "welfarism" in England, it might be assumed such judicial and, more importantly, legislative restraints on contractual freedom have never been in vogue in Hong Kong, reputedly one of the world's "freest" economies. Hong Kong has certainly proved less interventionist than England in this regard. This reflects Hong Kong's avowed free market approach and its freedom from EU law encroachment, the largest factor in the growth of consumer protection legislation in England. Yet, even in Hong Kong, legislation and judicial intervention have put limits on

36. See *Liverpool City Council v Irwin* [1977] AC 239 and 8.4.
37. See, for example, P.S. Atiyah, *The Rise and Fall of Freedom of Contract* (Oxford: Clarendon Press, 1979).

unfettered market freedom. There may be a free market in *goods*, yet legislation restricts the "market" in *money* in that there is a limit on the interest rates which moneylenders (though not banks) are permitted to charge. If "market competition" worked perfectly there would be no need for such restrictions. Employment legislation imposes regulations as to working conditions, rest days and the Mandatory Provident Fund. It now also imposes a general minimum wage. Legislation also exists in relation to various forms of discrimination in employment practices. All of these changes to the law relating to the contract of employment can be seen as restricting the "freedom" of the employer and employee to negotiate their own contract free from outside interference. Implicitly, however, they recognise that total freedom of contract would allow the more powerful employer to dictate terms to the weaker employee.

Interventionist, welfare-based approaches are criticised by "free-marketeers" on the basis that they not only restrict freedom but also fail to have their desired effect of improving the lot of the poor and disadvantaged. It has been argued, by its opponents, that the introduction of a general minimum wage in Hong Kong will increase unemployment as firms "outsource" more jobs or relocate to areas where unskilled labour is cheaper. It could also be argued that more foreign domestic helpers would be employed in Hong Kong were the minimum wage (long-established in respect of domestic helpers) to be abolished. Proponents of the free market would assert that the protectionism involved in the setting of a minimum wage merely restricts the right of employers to make free bargains, on lesser terms, which many overseas domestic helpers would be more than willing to accept. Legislation here, therefore, involves a delicate balance between total freedom and the prevention of exploitation.

Probably the most conspicuous legislative restraints on the parties' ability to contract "freely" in Hong Kong are in the area of consumer protection. The Control of Exemption Clauses Ordinance (CECO), dealt with in chapter 8, and the Unconscionable Contracts Ordinance (UCO), dealt with in chapter 12, are important examples of such statutory intervention.

1.2.1.2 Judicial Restraints on Freedom of Contract

It has been said that "English judges have always been stronger in doing justice in a pragmatic fashion"[38] since English legal education and training tend to be practical rather than theoretical. Given their similar educational and training background, the same "pragmatic" approach can be seen amongst the Hong Kong judiciary. The approach of the judges may be seen in terms of enforcing freely-made agreements in so far as to do so does not produce an "unjust" or unfair result. Where, however, freedom of contract has resulted in the imposition of terms by a dominant party on a weaker one, the courts are likely to intervene.

38. Atiyah (ibid), p 405.

The search for a "fair" solution appears to contradict the view that contract law is not concerned with fairness; that if one party has freely made a bad bargain he should be expected to keep to it. Indeed, it has been said that:

> In commercial transactions one party may take advantage of his greatly superior bargaining power to drive a very hard bargain . . . A party may also take advantage of his superior knowledge.[39]

In the case of *Turner v Green*,[40] the plaintiff solicitor took advantage of his knowledge of the outcome of a case to make a favourable contract with the defendant who, the plaintiff knew, was unaware of the result of the case. The court held that this was a "shabby trick" but that the contract was nonetheless valid. More recently, in *Walford v Miles*,[41] the House of Lords underlined the "adversarial" nature of bargaining. Lord Ackner said:

> Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations.[42]

The role for the court, according to common law principles, is to uphold hard bargaining but to determine when the line has been crossed such that the agreement infringes specific common law or statutory rules.

Certainly the law on consideration supports the "freedom of contract" rule, since the rule is that "consideration need not be adequate"; that what one party gives need not be equal to the other party's contribution to the contract. In practice, however, the fairness, or unfairness, of a bargain is likely to be significant in a number of ways; "mere" unfairness will not invalidate a contract but the unfair nature of a contract may encourage the courts to look for other "vitiating" factors. So, for example, a written agreement to sell a valuable car for $100 might be acceptable from a consideration point of view. In such circumstances, however, the courts are more likely to believe the "victim's" assertion that he was tricked or threatened and invalidate the agreement accordingly.

An obvious illustration of the relevance of fairness in contract is provided by the example of equity, which is specifically preserved, by the Basic Law, as a source of law in Hong Kong post-1997.[43] Equity was founded on principles of morality and its main court, Chancery, was a "court of conscience". While the courts of common law and equity were fused well over one hundred years ago in England, the role of equity as a "court of conscience" remains. The maxims of equity still direct the courts in the exercise of their discretion whether or not to grant equitable relief. The principle that "he who comes to equity must come with clean hands" means that equitable

39. R. Brownsword (ed), *Smith & Thomas: A Casebook on Contract* (London: Sweet & Maxwell, 13th edn, 2015), p 33.
40. [1895] 2 Ch 205, referred to in *Smith & Thomas* (ibid), p 29.
41. [1992] 1 All ER 453, discussed at 3.8.5.
42. Ibid at 460.
43. See 2.2.

remedies, or "relief", will only be granted to those who have acted fairly in respect of the contract.[44] The principle that "he who seeks equity must do equity" means that equitable relief will be granted only where the claimant is prepared to comply with the requirements of the court to do justice to the other party.[45]

As a further example, it is now generally recognised that the rationale for finding that an agreement is "frustrated",[46] by a post-contractual event which makes performance impossible, is that it would be unfair to demand contractual performance in such cases.

"Fairness" is also relevant to the question of non-statutory "unconscionability", as well as the statutory form mentioned above.[47] Hong Kong courts have overturned agreements on the basis of unconscionability where one party has taken advantage of a superior bargaining position to produce an unfair agreement. In *Lo Wo and Others v Cheung Chan Ka Joseph and Another*,[48] a Hong Kong court overturned, for unconscionability, the sale of a half share of property in Hong Kong by elderly mainland women. The main justification for the court's action was that the buyers had failed to mention that they had paid far more for the other half share and had not advised the sellers to take independent advice.

While the above examples may be seen as limited exceptions to the principle of contractual freedom, it has been argued that there has been a more general shift by the courts away from freedom of contract towards an interventionist approach seeking to protect the weaker party from the stronger in an attempt to produce a "fair" result.

Reiter states:

> the courts have overridden 'contract principles' and have established limits on the exercise of contract power . . . Through a great variety of techniques, the courts have paid lip service to contract law in theory, and have ignored it in practice.[49]

Reiter's view is that judges have intervened consistently in order to achieve a "fair" result at the expense of the principle of contractual "freedom". A clear example would be the judicial refusal to uphold contractual "penalties" even where they have been freely agreed by the parties. While this may be true of English judges, it is questionable how relevant it is to the Hong Kong scenario where the tradition has been, at least until recently, to apply the approaches of the English courts rather than to adapt precedents to perceived Hong Kong needs. Even here, however, there appears to be a gradual change. The *Lo Wo* case, considered above, is a clear example, since the

44. See *D&C Builders v Rees* [1966] 2 QB 617, [1966] WLR 288, [1965] 3 All ER 837 discussed at 4.7.3.3.
45. See *Cheese v Thomas* [1994] 1 WLR 129, [1994] 1 All ER 35 discussed at 11.2.4.
46. See 14.4.
47. See 1.2.1.1 and chapter 12.
48. [2001] 3 HKC 70, discussed at 12.2.
49. B. Reiter, "The Control of Contract Power", (1981) 1 Oxford Journal of Legal Studies 347 at 360.

court could have held that the buyers had merely exercised their right to strike a hard bargain and that the elderly sellers had acted imprudently.

1.2.2 Judicial Creativity in Contract Law

What the "fairness" discussion indicates is that judges actually have far more flexibility than is generally believed by the layman. Many Hong Kong students commence their studies believing that the "answer" to a legal problem should always be discoverable by an application of the relevant statutory and "common law"[50] rules to the facts of a case. Statutory rules must be followed by the courts and past judicial "precedents" from the higher courts must be adhered to. This should produce predictability and certainty in the law; a potential claimant, or his legal adviser, should be able to predict the outcome of proposed litigation and respond accordingly. Indeed, in a truly "certain" system cases should only come to court on novel points of law not previously covered by legislation or judicial decision. Such a "rational"[51] system would leave no creative role for the judge; his role would be merely to "find and apply" the relevant rules. In practice, this narrow view of the judicial function is generally seen as unrealistic, especially in common law systems[52] where most of the rules are to be found in previous decided cases rather than legislative rules or written codes. In determining any case, a judge has to decide which *facts* are "relevant". Even more importantly, the judge has to determine which *rules* are relevant. Those precedents which would produce an unwelcome decision may be found to be irrelevant or inapplicable in the present case. Even legislative rules do not produce the certainty the layman tends to assume, since laws must be first "interpreted" before they can be applied, and that interpretation has to be made by the judge (or judges).

Further scope for judicial flexibility is provided by the emphasis, in common law systems, on the concept of "reasonableness". Agreement is judged, as we have already seen, primarily on the basis of whether a "reasonable man" would assume agreement in the circumstances; the validity of an exemption clause may depend on its "reasonableness", and an innocent party must take all "reasonable" steps to keep loss resulting from the other's breach to a minimum (to "mitigate"). In all such cases, of course, the ultimate decision on reasonableness is a matter for the judge.

In short, therefore, the common law system is far more flexible than it first appears and judges often "create" law rather than simply finding and applying it. The very fact that senior judges, in a particular case, may disagree strongly as to its outcome illustrates the lack of certainty in the law. Throughout this book you will see examples of judges reaching very different conclusions as to the proper outcome

50. Considered in more detail in chapter 2.
51. See M. Weber, *On Law in Economy and Society* (Cambridge, MA: Harvard University Press, 1954).
52. In this context, "common law" refers to those legal systems which derive from the English rather than the Continental European system.

of a case or, even where they agree as to the outcome, differing as to the reasons for it. Schur writes:

> Judicial precedent and legal doctrine can be found or developed to support almost any outcome. The real decision is made first—on the basis of the judge's conceptions of justice—and then it is 'rationalized' in the written opinion.[53]

To Schur, then, the decision comes first and the explanation follows. A less extreme view is expressed by Lord Radcliffe, a former House of Lords judge, as follows:

> there was never a more sterile controversy than whether a judge makes law. Of course he does. How can he help it? The legislature and the judicial process respectively are two complementary sources of law making.[54]

There may be scope for disagreement as to the scope for creativity. Paterson[55] found that some law lords dealing with final appeals thought there would rarely be a "right" answer; others felt that in many cases the decision inevitably went one way.[56] What we can say with some assurance is that the student coming to contract for the first time is likely to be surprised by the relative lack of certainty in the law and the scope for judicial disagreement.[57]

Judicial creativity, while generally seen as an attempt to do justice in a particular case, is not without its problems. The first is that it erodes the principle of treating like cases alike and the accompanying certainty in the law. If judges can ignore or overrule existing precedents at will, contracting parties will not know where they stand. Commercial contracts may be drawn up, after legal advice, on the basis of the law as it stands. Some would argue that it is more "just" to uphold the existing law, even if it is "defective", than to change the law and cause resentment and confusion as a result.

It is also the case that seeking a "just" solution depends on the judge's perception of what is just in a particular case. This, as the so-called "realists" argue, depends on his social and political view of the world. While we have so far attributed a benign role to judicial creativity, others would see it in less positive terms, ranging from deliberate political or "class" bias to an unconscious lack of sympathy for those of a different background. Scrutton LJ has said:

> The habits you are trained in, the people with whom you mix, lead to your having a certain class of ideas of such a nature that, when you have to deal with other ideas, you do not give as sound and accurate judgments as you would wish . . . It is very difficult sometimes to be sure that you have put yourself into a thoroughly impartial

53. E.M. Schur, *Law and Society* (New York: Random House, 1968), p 43.
54. Lord Radcliffe, *Not in Feather Beds* (London: Hamish Hamilton, 1968), p 215.
55. A. Paterson, *The Law Lords* (London: Palgrave-MacMillan, 1982), pp 190–193.
56. The legal "formalist", Ronald Dworkin, believes that, invariably, there is a "right" answer but that judges frequently fail to find it.
57. See, for example, the *Schuler v Wickman* case discussed at 8.5.2.

> position between two disputants, one of your own class and one not of your own class.[58]

How applicable is this to Hong Kong judges? There has been remarkably little research in this area, in part, perhaps, because colonial judges were seen largely as applying English law, subject to exceptions, and not to be cultivating a distinct Hong Kong jurisprudence. In short, Hong Kong judges have not been seen as a suitable topic of research in their own right.[59] However, much of what has been said about the background of the English judiciary would be echoed in Hong Kong, at least until recently. Most Hong Kong judges were from the more wealthy sections of society. They were either expatriates (usually British) or local judges trained at the English Bar. They would tend to have the same "conservative" (with a small "c") outlook and would prescribe to the view that individual effort rather than collective strength is the ideal. Of course, post-1997, the official political allegiance of Hong Kong judges has changed, and judicial demography is changing too, as colonial-era judges retire and are replaced by local judges. This change is particularly noticeable at the lower levels of judicial office. One clear reflection of the change is the increased proportion of cases heard entirely in Chinese. Nonetheless, at the highest level of the judiciary, the stereotypical judge will have been educated for some years in England, have studied for the English Bar and be from a relatively privileged background.[60]

As to the extent that the judicial background described affects decisions, it is difficult to draw conclusions, except to the effect that Hong Kong judges continue to be heavily influenced (some might say "over-influenced") by English decisions, even those made post-1997 and therefore not binding in Hong Kong. This is a theme to which we will return in chapter 2.

1.2.3 Contract Law as Dynamic

We can see, then, that judges have the capacity to adopt a creative role in order to achieve what they perceive as a "just" solution. Where such creativity follows a pattern, contract law will be seen to be evolving. In fact, such evolution is inevitable since the "stories" (cases) change significantly over time and the stories inevitably help shape the law. Nineteenth century contract law is dominated by tales of smoke balls, letters lost in the post and the sale of oats and horses. Today contracts are made on the internet, few know what oats are, and horses are seen, in Hong Kong, only in Shatin or Happy Valley. We should not be surprised that different rules are required

58. Quoted in J.A.G. Griffith, *The Politics of the Judiciary* (Glasgow: Fontana, 1977), p 173.
59. A notable exception exists in the work of the University of Hong Kong Professor Simon Young who has extensively researched the work of the Court of Final Appeal. See S.N.M. Young and Y. Ghai (eds), *Hong Kong's Court of Final Appeal* (Cambridge: Cambridge University Press, 2013), chapters 6 and 10.
60. See 2.4.

when disputes are more likely to concern construction, employment contracts and cancelled flights.

But is contract law sufficiently adaptable to changing social conditions? One dilemma for the courts is the extent to which they should reflect current commercial practice. It has been argued that, unless courts do this, contracting parties will not use the courts and will seek alternative methods to resolve disputes. Scrutton LJ has stated:

> I regret that in many commercial matters the English law and the practice of commercial men are getting wider apart, with the result that commercial business is leaving the courts and is being decided by commercial arbitrators with infrequent reference to the courts.[61]

Already, in Hong Kong, we see an increase in the use of alternative dispute resolution (ADR) despite the fact that the costs of such alternatives are rarely less than those involved in litigation. ADR is used particularly widely in specialised areas such as construction law.[62] The English case of *Williams v Roffey*,[63] and its Hong Kong counterpart *UBC (Construction) Ltd v Sung Foo Kee Ltd*,[64] can be seen as examples of the courts trying to make decisions in line with existing practice—what "everyone does" in building and construction—at the expense of long-established rules of consideration in contract. The counter-argument is that law should not be merely "reflective" but should retain a role as "educator"; to make pronouncements on what business practices should be, rather than merely reflecting, uncritically, what they are.

Lord Devlin[65] recognised that judicial creativity could take two forms: "activist" and "dynamic". The former, which he supports, involves judges reaching a decision "creatively" so as to bring the law in line with the common consensus. The latter involves judges being creative so as to change the existing consensus and point the way to reform; this he disapproves of, regarding such change as a task for the elected legislature. It is clear that analogies with Hong Kong are difficult; consensus may be hard to identify in a democracy but in a non-democratic entity like Hong Kong it is far more so. Arguments that dynamism should be left to elected representatives are also inapplicable to a largely (non-elected) executive-led entity. Whatever the merits of Devlin's view, we will see clearly in the following chapters that there have been dynamic contract law changes in the twentieth century, in relation to the phenomena of agreement, consideration, the effect of undue influence on third parties, remedies for non-financial loss, and the effect of mistake, all of which are the results of judicial creativity rather than legislative intervention.

61. *Hillas & Co Ltd v Arcos Ltd* (1932) 147 LT 503 at 506.
62. Taking the forms of arbitration, mediation and, imminently, statutory adjudication.
63. *Williams v Roffey Bros & Nicholls (Contractors) Ltd* [1990] 1 All ER 512, and see 4.5.
64. [1993] 2 HKLR 207, and see 4.5.2.
65. See P. Devlin, *The Judge* (Oxford: Oxford University Press, 1979), pp 5–17.

There are, however, limits on judicial creativity and dynamism. In particular, "bad" or outdated rules need to be considered by a higher court before they can be overturned. Where this higher court is the House of Lords (or its successor the Supreme Court) or Hong Kong's Court of Final Appeal, access is an important issue. In practice, poor decisions may never be appealed (or poor principles may never be questioned) because the costs involved in any potential appeal to the highest court outweigh the potential benefits (especially since risk is always involved). In England, for example, appellate courts have "raised judicial eyebrows" at the so-called "fiction of fraud" applied in the Court of Appeal case of *Royscot Trust Ltd v Rogerson*[66] but, absent a direct challenge in the Supreme Court, the fiction must continue to represent the law. Similarly, lawyers representing the losing party in *Collier v Wright*[67] were astonished by an adverse Court of Appeal decision, which appeared to fly in the face of established principles, but felt unjustified in appealing given the relatively small sums involved. Creativity in Hong Kong has been further restrained, at least until 1997, by the dominant position of the English common law, such that departure from its established principles was only possible in cases where Hong Kong legislation had amended the common law or where there was clear evidence that the English common law was inconsistent with local conditions.

Development of the law, where judges have proved unwilling or unable to respond to changing social needs or conditions, requires legislation. This has been enacted in Hong Kong, especially in the field of consumer protection; in relation to the control of exemption clauses and restrictions on "unconscionable" contracts for example. However, legislative action has generally been tardy[68] and often inadequate. One problem has been that Hong Kong legislation tended to mirror that in England, irrespective of local conditions and despite criticisms of the legislation in England.[69]

Such legislative reform as has been enacted in Hong Kong has generally followed reports and recommendations by the Law Reform Commission of Hong Kong (LRCHK) and it is a matter of some concern that a significant number of recommendations, made in LRCHK Reports some time ago, have not been adopted legislatively. The post-1997 record of legislative follow-up to LRCHK recommendations has been lamentable. It is to be welcomed that, following criticism of this

66. [1991] 3 All ER 294.
67. [2007] EWCA Civ 1329, discussed at 4.7.3.5.
68. The Control of Exemption Clauses Ordinance (Cap 71), for example, was enacted 12 years after its English forerunner, the Unfair Contract Terms Act 1977.
69. The Misrepresentation Ordinance (Cap 284), for example, did nothing to deal with the major ambiguities and uncertainties of the English Misrepresentation Act 1967.

situation,[70] legislative reform (in the contract law-related area) has finally been enacted in relation to privity of contracts.[71]

1.2.4 Enforceability

What all approaches to contract law agree on is the significance of enforcement. If freedom of contract has been eroded, the principle of "sanctity" remains firmly established. Sanctity of contract requires that once contractual promises are made the law will enforce them, irrespective of factors which may make performance difficult or impossible. "Enforcement" does not, generally, mean that a contracting party is compelled by the courts to perform as promised since, as American jurist, Oliver Wendell Holmes, has stated:

> The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it and nothing else.[72]

It is on this basis that "legal economists" talk of "efficient breach", whereby a party may "efficiently" break his contract where the other party's recoverable loss would be less than the profit it obtained via the breach.

Contractual duties are, in other words, regarded as "absolute". The best-known statement as to the absolute nature of obligations is to be found in the old case of *Paradine v Jane*,[73] where it was stated:

> but when the party by his own contract creates a duty or charge upon himself, he is bound to make it good, if he may, notwithstanding any accident by inevitable necessity, because he might have provided against it by his contract.[74]

The context of the words makes clear that the "may", which appears to allow some excuse for non-performance, is restricted to performance which would be illegal. The more recent doctrine of frustration has provided some alleviation of the sanctity principle, but is only rarely applied. Non-performance may be allowed in cases other than supervening illegality but only in extreme situations, where performance has become impossible or where the supervening event has destroyed the whole underlying basis of the contract.[75]

Outside the doctrine of frustration there is little judicial support for the relaxation of the principle of the "absolute" nature of contractual obligations. There is some tension, however, between the absolute theory and the recognition that, in

70. The *South China Morning Post* reported in December 2010 that, of 27 post-1997 Law Reform Commission Reports, 22 had not been implemented by legislation: see "Series of Law Reform ideas left to gather dust", 20 December 2010.
71. In force (in diluted form) some 12 years after the Commission's recommendations for change! See chapter 16.
72. O.W. Holmes, "The Path of the Law", (1897) 10 Harvard Law Review 457 at p 462.
73. (1647) Aleyn 26.
74. Ibid at 27.
75. See 14.4.

contracts of a continuing nature especially, "things change" and parties expect to be able to renegotiate in situations where new circumstances have arisen falling short of frustration. This sort of situation is encompassed in the so-called "relational" theory of contract, which recognises, for example, that continuing relations over a period of time, as opposed to "one-off" contracts, require that the parties allow for a measure of adaptation over time.[76] This may be done expressly within the contract by such devices as price variation clauses. In reality, however, changes are more likely to be based on implied assumptions by the parties that terms will not remain inflexible indefinitely.

Enforceability, in common law systems, also connotes more than the mere existence of possible redress for breach. It involves also the nature of the procedures for redress. Hong Kong is frequently said to have a "competitive advantage" over the PRC because of its "rule of law". Yet, if we look at the recently drafted contract law "code" in the PRC we can see that its rules are very similar to those in Hong Kong. Wherein, then, lies Hong Kong's advantage? The answer lies in the difference between "form" and "substance" or what some writers call "law in books" as opposed to "law in action". Hong Kong's system may be far from perfect: the rich get better access to justice than the middle class, for example. Nonetheless, those who come to court with a contract dispute in Hong Kong, unlike litigants in the PRC, can expect an impartial decision based on the evidence, by a judge who will give his decision free from state interference and without fear of the consequences. The "loser" may dislike the decision but he will have been fairly heard. Hong Kong courts have shown themselves prepared to find against the Hong Kong government (though it has not always accepted the decision!)[77] and to make judgments critical of the most powerful companies. For an excellent example of a judgment highly critical of one of Hong Kong's most important institutions see Waung J's judgment in *Esquire Electronics Ltd v Hong Kong and Shanghai Banking Corporation Ltd* discussed in chapter 11. While the judgment itself, including the tone of the trial judge's remarks, was the subject of severe criticism in the Hong Kong Court of Appeal, this was based on perceived errors of law and procedure, including excessive judicial delay, which rendered the judge's remarks unjustified.

A number of writers have suggested that enforcement is not the prime consideration of contracting parties. They indicate that parties tend to think more in terms of the contractual terms "defining" their contractual obligations and providing guidelines. No doubt, given the time and expense involved, parties will generally wish to avoid litigation, especially when the parties have dealt with one another over a

76. See, for example, D. Campbell (ed), *The Relational Theory of Contract: Selected Works of Ian Macneil* (London: Sweet & Maxwell, 2001).

77. In his research in this area, Professor Simon Young of the University of Hong Kong found that Hong Kong's Court of Final Appeal had found against the government in around 50% of cases (see Young and Ghai (eds), n 57 above, at p 163). This compares with Macau's one adverse government decision in its first 11 years! Cf J. Godinho and P. Cardinal, *Macau's Court of Final Appeal* in Young and Ghai (eds), chapter 23.

considerable period. It may also be the case that, for many parties, loss of reputation would be a greater consideration than the amount of damages involved.[78] However, as a "last resort", the existence of contractual remedies available via a competent and trusted legal system is a key factor influencing the initial creation of a contract. This is especially true for contracts which are likely to involve heavy cost and a lengthy performance time.

One key feature of litigation in common law systems is that the result is likely to be a "win/lose" situation, with the court finding for one party or the other. Some flexibility exists in that the court may not find for the claimant on all counts and may not always award full costs against the loser. There is also some scope for flexibility where an "equitable" remedy is sought, since the court may insist that the "winner" makes some allowance to the loser. Essentially, however, where the plaintiff wins, the defendant loses and it might be thought that this runs counter to traditional "Confucian" principles of compromise. Discussion of compromise raises the issue of alternative dispute resolution (ADR), especially in the form of mediation. Mediation is a growth area in Hong Kong, encouraged by the former and current Secretaries for Justice and both post-1997 Chief Justices.[79] Mediation is seen by its supporters as a beneficial means of resolving disputes, intended to avoid or reduce conflict and especially valuable where, as in matrimonial disputes, the parties will need to continue interaction. Critics of mediation, both in Hong Kong and Britain, see it as a cost-cutting measure frequently denying to deserving claimants the benefits of genuine litigation.[80]

Arbitration has a special significance for post-1997 Hong Kong, given the rapid increase in cross-border (strictly "cross-boundary") integration and the "joint venture" agreement. Enforcement of cross-boundary contracts is crucial if confidence is to be maintained in the integration process and, while mutual enforcement of civil judgments has been agreed in respect of cross-boundary contracts, the practical reality is that Hong Kong businessmen prefer to effect enforcement via the mutual recognition of arbitral awards.[81] Hong Kong has great aspirations for its arbitration system and intends to become a major world forum for arbitration, given its unique position as a (common law) gateway to the PRC contractual market.

The "win/lose" consideration raises the more profound question of whether Hong Kong's esteemed "rule of law" in general, and contract law in particular, should be seen as a "colonial" relic unsuited to an increasingly Chinese society.

78. This may well have been the case in respect of HSBC's appeal in the *Esquire* case (above) where its good name had been seriously called into question at first instance.
79. At the 2008 Opening of the Legal Year, for example, then Chief Justice Andrew Li stated that: "The benefits of mediation have been increasingly recognised in Hong Kong. The governing bodies of both branches of the legal profession fully understand its importance and are committed to its development. The promotion of mediation is now a matter of government policy."
80. See, notably, H. Genn, *Judging Civil Justice* (Cambridge/New York: Cambridge University Press, 2009).
81. Essentially there is much greater confidence in the PRC arbitration system than in its courts.

Pragmatically, whether or not this is so, what we shall see in chapter 2 is that the English rules of contract continue to exert huge influence on Hong Kong's own contract law. This is so both because of guarantees for the continuation of the common law, post-1997, and because, over the years of British rule in Hong Kong, common law concepts have become instilled in what is now the Hong Kong SAR, not least amongst the lawyers and judges who make the system work. Moreover, in form, at least, mainland China's own contract law is becoming increasingly aligned to common law principles rather than its previous socialist foundations. This leads us to ask what, if anything, is "special" about Hong Kong's law in general and contract law in particular.

1.3 Is Hong Kong's Contract Law "Special"?

Any discussion of the special nature of Hong Kong law must start with its unique constitutional experiment, Deng Xiaoping's "one country, two systems", enshrined in Hong Kong's post-1997 constitution, the Basic Law. While the Basic Law is of chief concern to public/constitutional lawyers it is central to an understanding of every branch of the law in Hong Kong today. Crucially, the Basic Law guarantees the continuance of the common law and Hong Kong's capitalist[82] way of life (for at least 50 years) while confirming Hong Kong's status as part of the People's Republic of China (PRC). Hong Kong constitutes, therefore, a small common law island in the midst of a vast civil/socialist law sea.

In comparing Hong Kong with the rest of the common law world, therefore, it can be seen as untypically undemocratic[83] and with limited power over its legal and political affairs. This limitation, however, has had little effect, in practice, on Hong Kong's legal development.

Much more significant has been the continuance of the colonial government's close (some would say sycophantic) relationship with big business. As many common law jurisdictions have evolved from "freedom of contract" models towards consumer-welfarism, Hong Kong has remained dedicated to the interests of big business at the expense of the consumer/employee. While a minimum wage was finally introduced in 2011,[84] employment protection is very poorly developed and those found to have been unfairly dismissed receive inadequate levels of compensation.[85]

82. Given developments in the rest of China, capitalism is not under threat. Hong Kong's richest businessman, the recently retired Li Ka-shing, has been feted by the PRC.
83. The Basic Law permits an "orderly" transition towards democracy but, between 1997 and 2017, there has been almost no progress in that direction.
84. At HK$28 per hour.
85. The "activist" Cathay Pacific pilots found to have been unfairly dismissed for their union activities received moderate levels of compensation only because the judge was able to invoke the law of defamation (though the defamation compensation was significantly reduced on appeal: *Campbell Richard Blaeney-Williams & Others v Cathay Pacific Airways & Others* (2012) 15 HKCFAR 261).

Further examples of the pro-business approach (in the contract area) can be seen in the lack of legislative control of misleading developers/estate agents' claims as to new housing developments,[86] a constant source of consumer complaint. Proposed legislation to increase consumers' welfare is constantly halted or slowed by vested interests.[87] On the same day as the announcement that legislation would (finally) be introduced in relation to privity of contract and the supply of goods,[88] the government also announced the shelving of legislation in respect of unsafe products.[89] Some would see the lack of legislative intervention in the market place as evidence of sensible "non-intervention" in the free market.[90] Hong Kong is lauded as one of the freest economies in the world by those with only scant knowledge of the political reality.[91] Genuinely free economies encourage competition; the United States has rigorous anti-trust laws yet Hong Kong has only just implemented competition legislation first recommended (by the Consumer Council) in 1996.[92] The effects of non-intervention are not difficult to identify. Land sales, for example, on which the Hong Kong government has been able to base its low taxation system, are effected in a cosy relationship between the government and bidders whose practices bear little resemblance to genuine auctions. The vast majority of supermarket retailing is in the hands of a duopoly which eschews genuine competition.

In respect of the Hong Kong SAR, comparison (and interface) with the rest of China the contrast is one of *practice* rather than *form*, at least as far as contract law is concerned. Students of the common law coming to the PRC Code on Contract would find little that is unfamiliar to them. What is *fundamentally* different is how such law is developed and applied. Hong Kong teachers of contract law report that one of the most difficult concepts to convey to PRC students is that the law is generally to be found by reading cases rather by scrutinising the words of a code or statute. This has enormous significance for legal development, since common law principles support the view that an interpretation by a senior court will be adopted in later analogous cases rather than being determined *ab initio* by a subsequent court adopting its own interpretation.

A key distinction, which is reflected, again, in practice rather than form, is that of the independence and professionalisation of judges. Judicial independence is a fundamental principle of the common law and is expressly preserved in Hong Kong's Basic Law. Conversely, the PRC judiciary is constitutionally subservient to

86. "Bel Air on The Peak", for example, is not on The Peak. The *South China Morning Post* reports that the Law Reform Commission had recommended reforms in this area 15 years ago: "Series of law reform ideas left to gather dust", 20 December 2010.
87. The Chief Executive's "cabinet" (ExCo) is dominated by businessmen.
88. In the latter case, a mere nine years after the LRCHK's Report.
89. On the basis that the "community" [*sic*] is unlikely to reach consensus.
90. Such had been the justification for the delay of legislation on a minimum wage.
91. See, for example, the seminal *Free to Choose* by Milton and Rose Friedmann.
92. A *South China Morning Post* editorial on 25 February 2011 noted that Chief Executive, Donald Tsang, had pledged to begin legislative work "within 2007"!

the socialist "state".[93] There is also a huge difference in judicial *quality* between Hong Kong and the rest of China. Hong Kong's judges are selected from the best of practitioners from the Bar. Moreover, judicial training is an area which has been prioritised and developed. In the PRC, on the other hand, judicial expertise lags far behind. This is scarcely surprising given that the judicial class was all but eliminated in the Mao Zedong era and it is to the PRC's credit that a lot of improvement has subsequently been effected in a short time.[94]

In identifying what is special about Hong Kong's contract law it would be gratifying to say that, post-1997, Hong Kong has gone its own way and begun developing a genuinely local contract jurisprudence. Alas, there is little evidence of this and, even in respect of novel points of law, Hong Kong has tended to follow legislative and judicial practice from England. However, given the psychological boost of a robust 2008 clarification of Hong Kong's precedent position, post-1997, by the then Chief Justice,[95] there are signs that Hong Kong judges are now taking the opportunity to look elsewhere in the common law world for inspiration, where appropriate.

93. Article 9 of the Law on Judges (2000) dictates that judges must "support the Constitution of the PRC" which includes reference to the primacy of the Communist Party of China. Moreover, judges are appointed by (and more importantly removable by) People's Congresses (national or local).
94. Professor Albert Chen has described how law "neither existed as an academic discipline nor as a rational mechanism of social control" after the Cultural Revolution and how re-establishment did not begin until 1972: A. Chen, *An Introduction to the Legal System of the PRC* (Hong Kong: LexisNexis, 3rd edn, 2004).
95. See *A Solicitor v Law Society of Hong Kong* [2008] 2 HKC 1.

2

Sources of Hong Kong Contract Law

Overview

Hong Kong contract law, like Hong Kong law in general, has been dominated, for 150 years, by the common law of England. Hong Kong's post-colonial "constitution", the Basic Law, guarantees that the common law will continue in force for 50 years from the transfer of sovereignty of Hong Kong in 1997, but it is to be expected that, by a process of divergence, the common law of Hong Kong will become increasingly distinct from the common law of England.

The Basic Law, the constitutional basis for the Hong Kong Special Administrative Region (HKSAR), states that:[1]

> The laws previously in force in Hong Kong, that is, the common law, rules of equity, ordinances, subordinate legislation and customary law shall be maintained, except for any that contravene this Law, and subject to any amendment by the legislature of the Hong Kong Special Administrative Region.

The intention of this section is that the general principles of the common law will continue in force and that the specific rules existing before 1997[2] will also do so unless they are amended or found to be contrary to the Basic Law. While this appears to be a simple proposition, the operational realities are somewhat more complex and need to be examined in detail.

It is also clear that, while Hong Kong's judicial system now enjoys the right of "final adjudication",[3] Hong Kong may continue to be guided by the courts of other common law jurisdictions since the Basic Law expressly permits reference to such precedents.[4]

The intention, then, is that rules of English common law formulated post-1997 will be of no binding effect but merely available for guidance in the same way as the rules of any other common law jurisdiction. While this may be the theoretical

1. Article 8.
2. Although the transfer of sovereignty took place at midnight on 30 June 1997, we will refer to "pre-1997" and "post-1997".
3. Subject to exception relating to such matters as national security and foreign affairs.
4. Article 84.

position, in practice there is little doubt that post-1997 English court decisions weigh far more heavily with the Hong Kong judiciary than those of other common law jurisdictions, at least as far as the law of contract is concerned.

2.1 Hong Kong Contract Law before 1997

Following the Treaty of Nanking signed by China and Britain in 1842, Hong Kong became a legal possession of Britain. Later treaties, the Conventions of Peking of 1860 and 1898, ceded further territory to Britain, though under differing terms. After the Treaty of Nanking was ratified by Britain, a constitution for the new territory was established by two documents. The first, known as the Letters Patent, outlined the constitutional structure and conferred powers upon the governor while making provision for the assistance of an Executive Council and Legislative Council. The second constitutional document, the Royal Instructions, set out the rules relating to the composition of the Executive and Legislative Councils and detailed the procedures to be observed in the passing of laws.

After 1843, this constitutional framework allowed laws to be created in Hong Kong. One such example was the Supreme Court Ordinance (SCO), 1844,[5] which is significant in that it incorporated the laws of England, existing in 1843, into Hong Kong law. English laws were to have effect in the colony except as they might be inapplicable to local circumstances or inhabitants, and subject to any modification by the local legislative structure. The SCO also established the court system of Hong Kong.

In 1966 the Application of English Law Ordinance[6] (AELO) was passed. Section 3 provided that:

> (1) the common law and the rules of equity shall be in force in Hong Kong:
> (a) so far as they are applicable to the circumstances of Hong Kong or its inhabitants;
> (b) subject to any modifications as such circumstances may require;
> (c) subject to any amendment thereof (whenever made) by
> (i) any Order in Council which applies to Hong Kong;
> (ii) any Act which applies to Hong Kong;
> (iii) any Ordinance.

On 1 July 1997, AELO was "not adopted" as a law of the HKSAR via the procedure whereby the Standing Committee of the National People's Congress (NPCSC) is authorised to determine which of the laws previously in force are inconsistent with the Basic Law. This non-adoption confirms that Britain may no longer legislate for Hong Kong. AELO remains significant, however, in identifying which were the laws

5. No 15 of 1844.
6. Cap 88.

3

Agreement

Overview

As was stated in chapter 1, a contract may be described as a voluntary agreement that the law will enforce.[1] The parties are generally free to negotiate the terms of the contract and, in the absence of a recognised vitiating factor such as misrepresentation or mistake, the courts will not intervene or seek to "rewrite" the agreement.[2]

In order to establish the existence of a contractual agreement, a claimant can adduce oral and/or written evidence and may also be able to rely on the conduct of the parties. While the law requires the element of writing only in exceptional cases,[3] from the perspective of proof it is always advisable to reduce the agreement to writing.

While agreement is a necessary element it is not in itself sufficient; a claimant will also have to show consideration[4] and intention to create legal relations.[5] Where appropriate the claimant must also show that the other party had the legal capacity to make a contract.[6]

Agreement is invariably considered by the courts in terms of a clear offer and an unqualified acceptance thereof. This is taken to be the clearest indication of a meeting of minds or "*consensus ad idem*". Consensus also implies that the "offeror's" intention to be bound should remain unchanged up the time of the "offeree's" acceptance. This, at least, is the traditional and generally accepted view. Lord Denning, a previous Master of the Rolls in England, tended to adopt a more "flexible" approach to the issue of agreement. He expressed the view that courts should look at the overall situation: if the parties have reached agreement on the material terms, a contract should be found irrespective of whether "offer and acceptance", in the strict sense, exist. The English House of Lords[7] favoured the traditional approach and it will be

1. But see chapter 1 as to qualifications in respect of the words "agreement" and "enforce".
2. See chapters 9–12.
3. See chapter 7.
4. See chapter 4.
5. See chapter 5.
6. See chapter 6.
7. Now replaced by the Supreme Court.

an exceptional case in which a contractual agreement is held to exist in the absence of a clear offer and acceptance.

It should be noted that this chapter is concerned with the question of whether a contractual agreement has been reached. The "meaning" of the contract (how it is "construed") will be dealt with in chapter 8.

3.1 The Significance of Agreement

The phenomenon of agreement is significant in that it provides an initial requirement for the very existence of a contract. It is also, as noted, in chapter 1, what distinguishes contractual obligations from tortious ones. Agreement also has the significance of regulating in advance many subsequent developments. The "reasonableness" of an exemption clause, for example, is to be judged, statutorily,[8] as at the time the contract is made. Frustration depends on what circumstances a party should have foreseen at the time the contract was made. A party in breach is liable for those consequences of his breach which should have been seen as likely at the time the contract was made. The question of whether a clause should be viewed as "liquidated damages" depends on the parties' expectations of possible damage at the time the contract was made. In all these cases the key point in time is the time when the agreement was made and the courts should not make determinations based on the advantages of hindsight.[9]

3.2 The Requirement of Offer and Acceptance

A valid contract requires agreement. This is usually defined in terms of a clearly defined "offer" being unambiguously "accepted". Exceptionally, it may be difficult to identify the elements of *offer* and *acceptance*. In *Clarke v Dunraven*,[10] the House of Lords found that there was a valid contract when an entrant in a yacht race collided with another causing the latter's boat to sink. Each entrant in the yacht race had signed an undertaking to abide by the rules of the yacht club but there was no direct contact between the plaintiff and defendant and it was therefore impossible to discern an offer and acceptance between them.

There may be other exceptional cases where it is difficult to identify a strict "offer" and "acceptance". For example, two people may have simultaneously signed a written contract that was prepared for them by a third person. Clearly there would be an intention to agree shown on both sides but neither party has, strictly, made an "acceptance" of an "offer". In such cases, however, a court would almost certainly uphold the existence of a contract; the written and signed "evidence" of a common intention would suffice. Another example occurs where a person becomes a member of a company by subscribing for shares from the company or acquiring them from

8. See Control of Exemption Clauses Ordinance (Cap 71).
9. But see discussion of the *Golden Straits* case in chapters 14 and 15.
10. [1897] AC 59 and see chapter 1.

4

Consideration

Overview

Consideration is a requirement, in English and Hong Kong law, for all "simple" contracts (ie contracts not made under seal). Stated in its simplest terms, consideration means the giving of something of value to the other contracting party. Consideration is essentially a creation of the common law system and is not generally required in civil law systems such as those found in most of Western Europe. That being so, it is useful to ask why we have a doctrine of consideration, what is its purpose?

What consideration does *not* do is to prove that an agreement is fair. The rule is that consideration must be "sufficient" (of some value) but need not be "adequate" (of equal value to the other party's consideration). There is nothing wrong, in consideration terms, with an agreement to buy a valuable painting for $10, (although it might indicate that the agreement has been produced by fraud or threat, either of which would invalidate the agreement).

Consideration is, essentially, a token of a party's intention to make a legally binding contract, as opposed, for example, to a non-binding social arrangement. That token takes the form of the giving of something valuable in the eyes of the law. Consideration may not prove that a bargain is fair or equal but it *is* evidence of a legally enforceable contract, as opposed to a mere friendly arrangement never intended to be contractual.

In practical terms, while it is said that each party must provide consideration, it is for the party wishing to enforce an agreement to show that he has provided consideration. This is the usual meaning given to the requirement that "consideration must move from the promisee". Any legal pleading based on breach of a simple contract must describe the plaintiff's consideration. So, for example, the buyer who wishes to enforce a sale must show that he has given something of value to the seller. This may be the fact that he has already paid the price for the goods *or* that he has made a binding promise to do so (which he has not broken). In the former case, the buyer's consideration is said to be "executed"; in the latter it is "executory". Both forms of consideration are recognised by the courts.

The doctrine of consideration has been criticised as artificial and unnecessary. It is said that, where courts wish to uphold an agreement, they are prepared to "invent"

consideration. Further, it is said, since the function of consideration is to provide evidence of an intention to make some contractual "bargain", rather than a merely social arrangement, a preferable approach would be to adopt the civil law emphasis on "intention", with the existence of consideration merely being a factor in determining the parties' intention. To take a simple example, if A promises B $500 if he will complete 50 "push-ups", B's completion of the act could clearly be seen as "executed" consideration. It might be, however, that in such a case a court would find that the parties never "intended" that such a trivial arrangement would constitute a binding contract.[1]

Despite the criticism of consideration from some judges and academics, the doctrine has remained largely intact and consideration remains a requirement for the formation of a contract and any "variation" thereof. The best-known definitions of consideration speak of the need for the party seeking to enforce the contract to show either that he has conferred some benefit on the other party or that he has incurred some detriment to himself. In many cases there will be both benefit and detriment. The buyer of goods will give the benefit of the price to the seller and incur the detriment of payment himself. It is not, however, necessary to show both elements. If a person swims across Hong Kong harbour in response to a promise of $5,000 reward to anyone who does so, he will incur a detriment but show no obvious benefit to the promisor.

In addition to the benefit/detriment requirement, it must also be shown that what the party seeking to enforce the contract has done, or promised, is in response to the other party's promise; it must be "the price of the promise". So, if our swimmer swam across the harbour the day *before* the promise of $500 reward was made, he could not claim the reward; he would not have done the act in response to the promise of reward. In legal terms, the swimmer's consideration is said to be "past" and the rule is that "past consideration is no consideration". Similarly, if the swimmer swam the harbour unaware of the offered reward of $500 he would not be entitled to it since his act would not in response to the promise of reward; his swim would not be "the price of the other party's promise".

Since the need for consideration is firmly established, most legal and academic debate is focused on the requirement that consideration must be of some value in the eyes of the law and the meaning to be given to "value", which normally requires that the party seeking to enforce the agreement, the "promisee", must have given some benefit to the other party or incurred some detriment to himself. The words "benefit" and "detriment" have a somewhat different meaning to the contract lawyer than to the lay person.

Is it "beneficial" to one party, for example, that the other promises not to bring a legal action which has no chance of success? The promisor, in one sense, is not

1. See chapter 5.

giving anything of value but the other party is getting the benefit of not having the trouble and expense of a legal action.

To take another example, is it "beneficial" to the other party not to break an enforceable contractual promise? Will a builder who promises not to "down tools" (stop work) be giving consideration for a promise by the other party to pay more?

The courts have recently expressed the view that such matters should be judged in terms of a "practical" rather than a legalistic approach. It might be thought improper that a party should be viewed as having given a benefit merely by promising not to break his contract; yet in practical terms the alternative would be for the other party to bring expensive legal proceedings which might produce inadequate compensation, many years later, against an opponent unable to pay. So, if A promises B *extra* remuneration if B will continue performance of the contract rather than break it, the attitude of the courts today is to accept the practical benefit in terms of consideration but to ensure that agreement was not produced by unfair pressure, known as "duress".[2]

In practice, given the lengthy duration of many modern commercial agreements, problems of consideration normally arise over the *variation* rather than initial *creation* of a contract. Prudent businessmen will often insert a "price variation" clause to protect themselves against serious market changes (such as cost of supplies or currency fluctuations) which would otherwise "ruin" their bargains. Where this does not happen, the party unaffected by the changes may well be prepared to pay more under the contract rather than lose the goodwill of the other contractual party or even put him out of business. It makes no commercial sense to insist on strict legal rights if the effect is to give you a right of action against someone who will never be able to pay. Again, the modern focus of the courts is on a practical rather than a legalistic approach.

As regards detriment, could it be regarded as "detrimental" that a party promises to forego a course of action that he had no intention to pursue? The apparent answer is that there is no detriment, since the "promisor" has really given up nothing. It could be argued, on the other hand, that he has given up his "legal right" to change his mind and pursue the action. Some authorities emphasise that the mere giving up of a "legal right" can constitute consideration. In practice, however, courts have refused to find consideration in such a case.

To take a second example, is there "detriment" if A promises to give up a course of conduct which he was legally entitled to pursue but which was physically harmful such as smoking cigarettes? Here we can see the clear distinction between "legal" detriment and "actual" detriment. The smoker has promised to give up his "legal right" to continue smoking; a "legal" detriment though a physical benefit. Presented with such a case, courts would probably accept the consideration but refuse to enforce

2. See 11.1.

the agreement on the grounds that there was no "intention" to make a contract as opposed to a merely social arrangement.

A specific example of the difference between legal and practical benefits can be seen in relation to the rules on part-payment of a debt. A rigid adherence to consideration would dictate that part-payment could not discharge a debt since nothing would have been given in return for the release from part of the debt. Practically, however, the creditor may well have obtained a benefit since some payment would be preferable to none and an insistence on full legal rights might result in the creditor ultimately receiving nothing from a bankrupt debtor. So far, the law has not been relaxed in this area[3] and part-payment continues to be insufficient to discharge the whole debt. However, the courts have mitigated the harshness of this approach to some extent via the doctrine of promissory estoppel, a form of "waiver", under which the creditor who has clearly agreed to accept part-payment, in full satisfaction of a debt, may be prevented, at least temporarily, from enforcing the debt contrary to his promise. Were the courts to adopt a more flexible attitude towards consideration in this area, and to consider the "practical" benefit of receiving part-payment, the need for equitable intervention would no doubt be reduced.[4]

4.1 The Nature of Consideration

The basic requirement of consideration is that each party must give something of value, in the eyes of the law, in return for the other party's promise. The presence of consideration does not prove that a "fair" bargain has been made but it does prove the existence of a bargain, which the law will enforce, as opposed to a gratuitous promise which is not enforceable.

Consideration is frequently described in terms of "benefit" and "detriment": the promisee must show either that he has provided a benefit to the other party or suffered a detriment himself. Thus:

> A valuable consideration, in the sense of the law, may consist either in some right, interest, profit or benefit accruing to the one party or some forbearance, detriment, loss or responsibility, given, suffered or undertaken by the other.[5]

It is important to note that it is not required to show detriment to oneself as well as benefit to the other party in order to enforce an agreement. Earlier cases may have suggested that *both* benefit and detriment are necessary.[6] However, it is clear that *either* will suffice. The person who walks from London to York in return for the promise of reward will be entitled to sue for that reward, on the basis of the detriment to himself, without showing that the walk provided any benefit to the promisor.

3. But cf 4.6 and 4.7 below.
4. Ibid.
5. *Currie v Misa* (1875) LR 10 Ex 153 at 162.
6. See, for example, the judgment of Byles J in *Shadwell v Shadwell* (1860) 9 CB (NS) 159.

5

Intention to Create Legal Relations

Overview

While it is well established that agreement (offer and acceptance) and consideration are essential to the formation of a contract, the requirement of an intention to create legal relations is more problematic, with a minority of academics arguing that intention is not, or should not be, a necessary contractual element. The basis of the minority view is that, since consideration is a token of the intention to be bound, to require a separate element of intention is unnecessary. Similarly, it can be argued that the requirement of offer and acceptance (agreement) obviates the need for a separate requirement of intention.

Given the considerable overlap with agreement and consideration, there is some merit in the argument that intention should not be a separate requirement. However, the clear pronouncements of the courts in a number of cases leads inevitably to the conclusion that the denial of the need for intention cannot be supported except to the extent that intention must be judged objectively, rather than subjectively.

The major argument produced by the courts for the separate requirement of intention is that, without it, the courts would be faced with a deluge of cases involving petty agreements which, though probably supported by consideration in the technical sense, were never intended to be anything other than friendly, or domestic, arrangements.

Given the requirement of intention, it is normal to divide agreements into those of a domestic or family nature and those which are "commercial". In the case of the former category, the courts normally adopt the presumption that there is no intention to create legal relations. However, this presumption is rebuttable if there is clear evidence to the contrary.

In the area of commercial arrangements, the opposite applies: there is a presumption of an intention to create legal relations. Again, this presumption is rebuttable but the cases strongly emphasise that this will be a heavy burden to discharge.

It has also been recognised, in Hong Kong, that there are exceptional cases where the agreement in question fits into neither the "social" nor "commercial" category.

6

Contractual Capacity

Overview

The general rule is that any person has the capacity to make a contract. Exceptions exist in relation to mental patients, drunkards, corporations, and minors. Of these, only the last two are significant and the rules on corporations are more suitably dealt with in the context of company law.

The law on minors, previously referred to as infants, is now similar in England and Hong Kong, having once been rather different. The Infants Relief Act 1874, which incorporated rules not enacted in Hong Kong, has now been abolished and similar common law and statutory rules are now found in both jurisdictions.

Three categories of contracts made with minors are recognised: enforceable contracts, voidable contracts and "other contracts". Before proceeding, it should be stressed that all three categories are enforceable *by* the minor;[1] the common law and statutory rules exist to protect the minor, *not* the adult who contracts with him.

"Enforceable"[2] contracts comprise contracts for necessary goods and services, and beneficial contracts of employment or service. When dealing with "necessaries" it should be remembered that this includes far more than the basic necessities of life. Any item necessary to maintain a particular minor in the "station of life in which he moves"[3] is within the definition. Thus, although courts might identify some items as "mere luxuries", incapable of being necessary, the usual question will be one of fact; is this item necessary for this particular minor? Those dealing with minors will, therefore, be at a disadvantage since no general definition exists; what may be necessary for a rich undergraduate may not be necessary for a poor, unemployed minor. Further, even the rich minor will not be liable where he is already well supplied with goods of the type for which he has contracted.

1. Though a minor cannot be granted specific performance, under the principle of "mutuality", since it cannot be awarded against him; see final paragraph of 6.3.1.2.
2. Although these contracts are described as "enforceable", the minor can only be required to pay a reasonable price for necessaries rather than the contract price. Specific performance can never be awarded against a minor.
3. Per Baron Parke in *Peters v Fleming* (1840) 6 M&W 42 at 46–47.

The minor's liability to pay for necessaries may be seen as being not strictly contractual at all, but "quasi-contractual", since liability is not to pay the agreed contract price but to pay a "reasonable" price. Further, it appears that the minor has to pay not because he has promised to do so but because he has received a benefit. Thus the minor is not liable to pay for necessary goods which he has ordered but delivery of which he has refused to accept. There is some authority for the proposition that necessary services must be paid for, having been requested, even though the minor subsequently refuses the services.

Contracts of service or employment are enforceable against a minor if they are substantially for his benefit. Of course, contracts may contain a mixture of terms, some favouring the minor and others not. The test is whether the contract is beneficial overall.

Voidable contracts comprise a variety of agreements which have little in common except that they confer a permanent, or at least long-standing, interest. Thus, contracts for the purchase of shares, partnership contracts and contracts for a lease are all voidable. The effect of voidability is that the minor may cancel, or repudiate, these agreements at any time during his minority or within a reasonable time after attaining majority. When the minor has repudiated he has no further liabilities under the contract. However, obligations which accrued before repudiation may have to be honoured.[4]

All "other contracts" are unenforceable against the minor though, again, the minor may enforce them. Within this category are minors' trading contracts and loans to minors. Both English and Hong Kong law now permit the possibility of the minor acknowledging or "ratifying" such contracts after reaching majority. Where ratification occurs the contract becomes enforceable against the minor.

The minor's immunity from liability for most types of contract does not extend to tort, where minors are generally liable. This might, potentially, provide an alternative form of action for the adult dealing with a minor. However, the courts have made clear that a tort action will not be permitted against a minor which would, in effect, amount to enforcing an otherwise unenforceable contract; the minor's tort liability will, therefore, only arise when he does an act outside the contemplation of the contract.[5]

The above rules indicate that the adult dealing with the minor is often in a disadvantageous position. Equity gave some relief to the adult by permitting the "restitution" of property obtained by the minor by fraud (for example, falsely purporting to be an adult, acquiring non-necessary goods and refusing subsequently to pay for them). The equitable remedy was limited, however, since it required evidence of wrongdoing by the minor and probably did not apply where the precise goods or money obtained could not be identified. Legislation has improved the adult's position

4. There is considerable uncertainty here since the decided cases are not consistent on whether the minor's repudiation affects prior obligations.
5. See *Ballett v Mingay* [1943] KB 281.

considerably since proof of fraud is no longer required and courts now have a much wider discretion as to what may be "restored".[6]

The prudent adult may also protect himself by requiring that the minor's liability be "guaranteed"[7] by an adult at the time of making the contract. Hong Kong law has always recognised the enforceability of such guarantees and English law has adopted the same position via legislation.[8]

6.1 Drunkenness and Mental Incapacity

Generally, the law gives some protection to those who make contracts while drunk (or drugged) or suffering from such mental incapacity that they do not understand what they are doing. The contract is "voidable" so that the affected party may rescind the contract provided it can be proved that the other party was aware of the affected party's incapacity. More emphatically, in cases where an order under the Mental Health Ordinance[9] has been made, the affected party's contractual capacity is formally ended and undertaken by others acting on his behalf.

Even where a contract is rescinded by the affected party on the grounds of the incapacity described there is a requirement to pay a "reasonable" amount for any "necessary" goods or services supplied under the contract. This is the same principle as that which applies to minors and the definition of "necessaries" and its significance will be dealt with below.[10]

6.2 Corporations

A corporation is a legal "person", capable, in law, of making contracts in the same way as an individual, subject to minor limitation. A corporation may be a corporation "sole" or corporation "aggregate". The former consists of one person only at any time, maintaining the same corporate identity where that person is succeeded by another as a result, for example, of resignation or death. The Archbishop of Canterbury would be a corporation sole.

A corporation aggregate consists of many individuals at any one time but has a single, separate, corporate identity. While the individuals in the corporation may change, its corporate identity remains the same.

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6. Minors' Contracts Act 1987 s 3, enacted in Hong Kong by the Age of Majority (Related Provisions) Ordinance (Cap 410) s 4.
7. Since a guarantee is an undertaking of secondary liability, it is arguable that, in the case of "absolutely void" agreements under the old Infants' Relief Act 1874, the adult was not a "guarantor" but an "indemnifier". The distinction is only important (in England) in terms of "formality" because guarantees must be evidenced in writing. This formal requirement no longer applies in Hong Kong (see chapter 7).
8. Minors' Contracts Act 1987 s 2.
9. Cap 136, ss 11–13.
10. See 6.3.

7

Formality

Overview

The general rule, in Hong Kong and England, is that contracts can be made in any form. Despite a common misapprehension on the part of the layman, there is no general requirement that contracts be made in writing (though reducing a contract to writing assists the question of proof in cases of dispute). Contracts may, generally, be made entirely orally or even, in exceptional cases, by conduct.

However, there are many important exceptions to the general rule on formality, some of which are of great significance. First, some agreements are required to be made by deed, notably those stipulated in the Powers of Attorney Ordinance (PAO).[1] Very importantly, in Hong Kong, a legal estate in land can be created, extinguished or disposed of only by deed: section 4(1) of the Conveyancing and Property Ordinance (CPO).[2]

Other types of contracts require particular formalities and these are contained in various statutory provisions. Some contracts must actually be "in writing" if they are to be enforced by one or both of the parties, notably various types of credit agreement.

Most important of all, in Hong Kong, the actual contract for the "sale or other disposition of land" must be evidenced in writing if it is to be enforceable at common law. The requirement of evidence in writing can be satisfied if there is a note or memorandum in writing containing all the essential terms and signed by "the party to be charged".[3] The memorandum need not be in any particular document and can even be formed by joining together two or more documents provided they relate to each other.

Under the doctrine of part performance, equity may intervene where there has been clear agreement and the parties have acted on this agreement but without sufficient written evidence. Examples of acts of part performance include taking possession of the property by the plaintiff with the consent of the defendant, alterations to

1. Cap 31.
2. Cap 219.
3. That is, by the person against whom the agreement is to be enforced.

the property or, exceptionally, payment of money. The doctrine of part performance continues to apply in Hong Kong, although it has been abolished in England.

The main reasons for requiring a particular form of contract are the need for certainty and the need to protect certain types of parties. The requirement that contracts concerning land have to be evidenced in writing dates back to the ancient Statute of Frauds, 1677, which was intended to protect those entering into important contracts by ensuring that they could not be sued on a contract unless they had signed the necessary written memorandum. However, the requirement of a "memorandum in writing" involves considerable complexity which could be simplified were Hong Kong to follow the English law lead for land transactions and substitute a requirement that the *contract itself* must be written.

Formal requirements also exist for the rescission or variation of a contract but these will be covered in chapter 14.

7.1 The General Rule

The general rule, in Hong Kong and England, is that contracts can be in any form. They can be made under seal or wholly in writing or evidenced by writing or orally or evidenced by the conduct of the parties or in any combination of these methods. It is important to note that the perception of many laymen that an oral contract is not as valid as a written one is incorrect. The problem that may arise with oral contracts is that it will be more difficult to adduce cogent evidence when dealing with issues that arise from a breach of an oral contract rather than a written one.

There are important exceptions to the general rule and they are contained in legislation covering certain types of contracts. Hong Kong and England differ substantially in these legislative exceptions; this chapter examines mainly the Hong Kong position; focusing on the most important areas such as contracts relating to land, guarantees, bills of exchange and promissory notes.

When considering the question of form, it will be assumed that other elements necessary for the formation of a contract: offer, acceptance, consideration, intention to create legal relations, certainty, capacity (and lack of illegality) are present.

Treitel[4] lists several purposes for the requirement of form. The first is that it promotes certainty as it is usually easy to see if the required form has been used. Second, it may enable a person to have longer to consider his position. Third, by providing a written record of the terms of the contract, it acts to protect a weaker party. As a general observation, the more valuable the consideration required for a contract the greater the need for these purposes to be met. This is particularly true of contracts relating to land. Formal requirements are also more likely in respect of those contracts which, by their very nature, involve a likely inequality of bargaining power, such as hire-purchase agreements.

4. Edwin Peel, *Treitel: The Law of Contract* (London: Sweet & Maxwell, 14th edn, 2015) at pp 205–206.

8

Contractual Terms

Overview

Having examined those elements necessary for the formation of a valid contract, we now turn to the contents or "terms" of the contract. Here a distinction must be drawn between those statements made by the parties which are regarded as part of the contract ("terms") and other statements which, even though they may *induce* the making of the contract, are not part of the contract itself ("representations"). This distinction is important, since a breach of a term gives the "innocent" party a right to sue for breach. In the case of "mere" representations, a right of action, if it exists at all, will lie in misrepresentation rather than breach.

Whether the statement is a term or not depends on various factors including the timing and importance of the statement, whether or not such a statement is usual, the relative expertise of the parties and whether or not the parties later produce a written agreement.

Terms may be express or implied. "Express" terms, of course, are those actually stated by the parties (either orally or in writing). The courts can, additionally, "imply" terms into a contract based either on the common law or statute. The courts are reluctant to imply terms into a contract on common law grounds and have produced a number of tests—principally the business efficacy and the officious bystander tests—to decide what the true intentions of the parties are and whether a term should be implied into the contract to give effect to those intentions. Statutory implied terms derive from many sources, the most important of which, from the contract perspective, is the Sale of Goods Ordinance.[1]

Courts are often called on to determine the "meaning" of express terms. Just as an objective test is used to determine whether the parties "intended" agreement *and* to determine whether they "intended" it to be binding, an objective test is used to determine the *meaning* of the contractual agreement. The test, put simply, is what a reasonable man (armed with the parties' background information) would have believed the parties to have intended by their words. In determining such meaning, it

1. Cap 26.

remains established law that the courts will not look at pre-contractual negotiations, since the parties' intentions may change before the contract is finally concluded.

Terms are not all of equal importance and may be classified as either "conditions" or "warranties". Breach of a condition entitles the innocent party to choose either to terminate the contract (and sue for damages if appropriate) or continue with the contract and sue for damages only. Breach of the lesser term, a warranty, only entitles the innocent party to sue for damages. The contract continues in existence.

The rigid classification of terms into conditions and warranties and the differences in remedies available to the innocent party, however, may result in injustice. A third category of intermediate or "innominate" term has, therefore, been introduced by the courts. This approach permits the court to determine the innocent party's rights based on the *effect* of a term's breach rather than on the status of the term itself. This affords the courts the flexibility to reach a "just" resolution in the circumstances of the individual case but at the expense of certainty.

A major emphasis of this chapter is the exemption clause. An exemption clause either totally or partially excludes the liability of one of the parties to a contract. As a result of concerns over the rights of consumers in their dealings with parties of greater bargaining power, the courts, and more recently legislation, have acted to restrict the scope of exemption clauses and, thereby, protect the interests of consumers.

If an exemption clause is to operate it must, at common law, be found to be a part of the contract; that is, it must be "incorporated" either in writing or via notice. It must also, of course, clearly cover the breach from which exemption is sought. If the clause does *not* unambiguously cover the breach, the courts will construe the clause against the party seeking to rely on it. The courts also refuse to allow reliance on exemption clauses where their effect has been misrepresented or where they are contradicted by a clear "overriding" statement of the "exemptor". The rules of "privity" may also be invoked so as to preclude a non-contracting party from taking the benefit of an exemption clause.[2]

Despite the efforts of the courts to reduce the scope of exemption clauses, legislators, in England and Hong Kong, have found that additional restrictions are necessary, particularly in the area of consumer protection. Major legislation, in the form of the Control of Exemption Clauses Ordinance (CECO),[3] was enacted in Hong Kong, based on previous English legislation.[4] CECO largely, though not exclusively, regulates the relationship between business and consumer. It encompasses attempts to restrict liability for breach, misrepresentation and negligence, precluding entirely certain types of exemption and making others subject to a test of reasonableness.

2. See chapter 16.
3. Cap 71.
4. The Unfair Contract Terms Act 1977.

9

Misrepresentation

Overview

The vitiating element of misrepresentation is concerned with those statements which are viewed as having played a part in inducing the making of a contract (representations) but which are not regarded as terms of the contract. So if a term of a contract is broken, the remedy sought will be for breach of contract; if a mere representation proves false, the remedy must lie in misrepresentation. The distinction between representations and terms, as already seen, is not always easy to draw.[1] One difficulty is that older cases sometimes involve courts eager to find a term, given the unavailability of a suitable misrepresentation remedy.[2] With the greatly improved remedies for misrepresentation since the Misrepresentation Ordinance[3] the courts are now unlikely to act so creatively.

The law on misrepresentation is concerned primarily with false, or inaccurate, "statements".[4] The focus is on positive affirmations of fact, and non-disclosure is generally beyond the scope of misrepresentation.[5] Indeed, despite the lack of a statutory definition of misrepresentation, the Misrepresentation Ordinance implies the need for a positive assertion rather than mere non-disclosure.[6]

Since there is no statutory definition, the meaning of "misrepresentation" must be gleaned from the relevant case law. A misrepresentation is "a false statement of fact which induces the representee to make a contract with the representor". This very basic definition requires considerable exposition since the extent to which silence can amount to misrepresentation, the meaning of "statement of fact", and the concept of "inducement" all require considerable elaboration.

Once a misrepresentation has been established, the representee (the person induced by the false statement) has two possible remedies: rescission and damages. Rescission was once the only remedy available in the absence of fraud or breach of

1. See 8.1.
2. See, for example, *Dick Bentley Productions Ltd v Harold Smith (Motors) Ltd* [1965] 1 WLR 623.
3. Cap 284, modelled on the UK Misrepresentation Act 1967.
4. The word "statement" is interpreted liberally; see 9.1.2.
5. See 9.1.2.1.
6. Since it talks of "a misrepresentation has been made to him by another party".

fiduciary duty. It requires that the parties return to their pre-contractual position. It may be possible for this to be done amicably, with the representor agreeing to the representee's call to cancel the agreement. Far more likely, the representee will need to seek an order for rescission from the courts. Rescission, a largely equitable remedy,[7] involves considerable discretion on the part of the court, since it will always have the power to reject the remedy and substitute damages "in lieu" (instead). Moreover, there are situations in which the court *must* reject rescission since one of the recognised "bars" to the remedy exists. In such circumstances it is doubtful that the court can give damages as an alternative.[8] The availability of rescission is, therefore, considerably restricted. It is also an inadequate remedy when consequential loss has been suffered. Equity does allow the award of an "indemnity" in addition to rescission but this is very restrictive in scope.[9]

Damages, the common law remedy, are far more readily available for misrepresentation since legislation was passed in the 1960s.[10] Prior to the legislation, the common law was very restrictive in that damages were available only in the unlikely event that the representee could prove fraud on the part of the representor.[11] Fraud was defined narrowly and required proof that the representor knew that what he was saying was false or that he was reckless as to whether it was false. The new legislation provided that the representee would be liable to pay damages for misrepresentation *unless* he could prove that his statement was made honestly and reasonably. Thus, for the first time, the *negligent* representor would be liable to pay damages. Moreover, the legislation introduced a presumption of liability; it is not for the representee to prove fraud or negligence, but for the representor to disprove them. Curiously, however, though the legislation is aimed primarily at the negligent representor; it treats him as if he were fraudulent and he must pay the same damages as would the deliberately deceitful representor. This feature of the legislation, the "fiction of fraud", is so strange that many academics refused to accept that the legislation would be so interpreted. Decisions, both in Hong Kong and England, however, leave no doubt that the "fiction of fraud" does exist. The practical consequence is that there will now be little point in the representor bringing an action asserting fraud since he will be better advised merely to bring an action under the Misrepresentation Ordinance which will produce as good a remedy and throw on the representee the obligation of disproving fraud and negligence.

It is possible to exclude liability for misrepresentation but only where the exclusion is reasonable.[12] Strangely, perhaps, statutory limitations on the right to exclude

7. Though the common law did permit rescission for misrepresentation in the rare situations where fraud could be proved.
8. See 9.3.4.2.
9. See *Whittington v Seale-Hayne* (1900) 82 LT 49.
10. The Hong Kong Misrepresentation Ordinance mirrored the English Misrepresentation Act 1967.
11. Although parallel moves to develop the tort of negligence had begun.
12. Misrepresentation Act 1967 s 3; Misrepresentation Ordinance (Cap 284) s 4.

liability for misrepresentation were introduced considerably before similar restrictions in relation to breach of contract.

The UK Misrepresentation Act 1967, though brief, is poorly drafted. It is impossible to understand without knowledge of the pre-existing law and, even then, only with difficulty. Yet, despite the immediate criticisms of the Act it was reproduced almost without amendment by the Hong Kong legislature.

9.1 The Scope of Misrepresentation

"Misrepresentation" is generally defined as a "false statement of fact which induces a representee to make a contract with the representor". This definition, which derives from the common law rather than statute, requires some further elaboration.

9.1.1 False

The word "false" applies to statements which are merely inaccurate. There is no requirement that the maker of the statement be dishonest. The nature of the *remedy* for misrepresentation may vary according to whether the statement was made fraudulently, negligently or innocently but a statement made both honestly and on reasonable grounds may nonetheless amount to misrepresentation.

9.1.2 Statement

The word "statement" indicates that misrepresentation requires some form of words, but actions, such as a nod of the head, which clearly convey a particular meaning may also be regarded as representations. In *Spice Girls Ltd v Aprilia World Service BV*,[13] the participation of a pop music group in the making of an advertising film was held to constitute a representation that the group intended to stay together for the duration of the advertising contract. Since one of the group had already decided to leave there was held to be a misrepresentation by conduct.

An act of concealment, such as hiding a defect, may be treated as equivalent to a statement that the defect does not exist. Covering dry rot in a house so as to conceal its existence is equivalent to a "statement" that the house is free from dry rot.[14]

9.1.2.1 Silence as Misrepresentation

Since there is no general duty of disclosure, "mere" silence will generally not amount to misrepresentation. In *Bank of China v PR of Fu Kit Keung (deceased)*[15] Chu J stated:

13. [2000] EMLR 478.
14. See *Gordon v Selico Co Ltd* (1986) 278 EG 53.
15. [2009] 5 HKLRD 713.

10
Mistake

Overview

Mistake is the most perplexing and academically complex of all the areas of contract. Some writers question the very need for its existence; others argue that its scope should be greatly limited.[1] Almost all text books now devote less coverage to mistake than was previously the case and many law schools omit mistake from their curriculum: avowedly because it is now less significant; in practice because it is too complicated!

The risk of making a mistake is always present when making a contract. However, the law of mistake is only concerned with the circumstances under which relief will be given to the mistaken party. In other words, the law will only grant relief when there is an "operative" mistake. Most "mistakes", as the term is understood by the layman, are inoperative. The shopper who spends too much on an item may well decide he has made a "mistake"; this will, of course, have no legal effect. To be operative, a mistake must be as to the terms of the contract and must be "reasonable". This "objective" aspect greatly reduces the scope of the doctrine of mistake since, generally, what is important is not whether a party is mistaken, but whether a reasonable person would have made such a mistake. Operative mistakes may take one of three forms: first, where both parties make the same mistake (common); second, where the parties are at cross-purposes (mutual); and third, where only one party is mistaken and the other party knows it (unilateral).[2]

The law of mistake is a complex one as it is extremely difficult to ascertain the *ratio* of many of the cases. Some important cases involve split decisions and the issue of mistake often overlaps with other areas of law such as offer and acceptance, misrepresentation and frustration.

The consequences of an operative mistake at law are that the contract is made void *ab initio* (from the beginning). This "all or nothing" approach can be harsh on an innocent third party who has obtained rights in the subject matter of the contract,

1. See, for example, C. J. Slade, "The Myth of Mistake in the English Law of Contract", (1954) 70 LQR 386.
2. This adopts the classification used by Cheshire, Fifoot and Furmston: M. Furmston, *Cheshire, Fifoot & Furmston's Law of Contract* (Oxford/New York: Oxford University Press, 17th edn, 2016), p 282.

as these rights can be overridden. In the past, therefore, equity intervened to provide a fairer result as between the various parties involved. The equitable approach is more flexible in that a mistake is more likely to be recognised and, if so, makes the contact "voidable"; that is, it may be set aside at the discretion of the court and made subject to such terms as the court thinks just. However, the role of equity in mistake has been controversial as it has been very difficult, if not impossible, to distinguish the test for an operative mistake at law from the test used by the courts for an operative mistake in equity. The very existence of "mistake in equity" is now questionable.

Two areas of mistake relate to documents. First, a document may be "rectified" if it does not accurately reflect the true intention so the parties. They may have written down an incorrect price or mistakenly entered other terms. Alternatively, one party may have made a mistake over the terms of the document and the other party may have deliberately taken advantage of this. An order for rectification will result in the amendment of the document to accord with the parties' true intention. The second area concerns the application of *non est factum* (it is not my deed). The application of this narrow principle serves to nullify the signature of someone who has radically misunderstood its significance. Both rectification and *non est factum* represent exceptions to the parol evidence rule[3] and the rule established in cases such as *L'Estrange v Graucob*[4] that one is bound by any document one signs; as such, the courts will only apply them in exceptional circumstances.

The role of the doctrine of mistake has been exhaustively re-examined by the higher courts in two English cases. First, in *Great Peace Shipping Limited v Tsavliris (International) Limited*,[5] the English Court of Appeal narrowed the application of equity in the area of common mistake. Second, the House of Lords in *Shogun Finance Limited v Hudson*[6] reaffirmed the strong presumption in cases of unilateral mistake that, in face-to-face situations, the contract is intended to be with the person with whom the offeror is face-to-face and not with some other person with whom he may have mistakenly thought he was dealing. Both cases have, therefore, resulted in restrictions being placed on the role of the doctrine of mistake. This role has been questioned repeatedly in the past, with some persuasive arguments for the proposition that there is no room in contract law for such a doctrine, overlapping as it does with other areas of contract law that do a much better job of achieving fairness between parties to a contract while at the same time preserving business certainty. However, there are still some areas of law where the only cause of action for a plaintiff is in mistake. This leaves the question of the apportionment of losses when an operative mistake is established. The present law on mistake often results in unfair treatment of an innocent third party and the only way to amend this position

3. See 8.2.
4. See 8.6.1.1.
5. [2002] EWCA Civ 1407.
6. [2003] 3 WLR 1371.

may be to enact legislation similar to that for the associated areas of frustration and misrepresentation.

10.1 Is a Doctrine of Mistake Necessary?

Serious doubts have been raised as to the need for a doctrine of mistake. In cases of "common" mistake, where both parties share the same mistaken belief, the law rarely recognises a mistake as operative unless it concerns the very existence of the subject matter (*res extincta*) or the acquisition of an interest in something the "acquirer" already owns (*res sua*). In both these cases it could be argued that there is an implied term that the subject matter still exists or does not already belong to the acquirer. Indeed, the implied term solution was preferred in the influential Australian High Court case of *McRae v Commonwealth Disposals Commission*.[7] It may be seen as significant that the "parent" case for common mistake is one where the expression "mistake" is nowhere to be found in the judgments![8]

There have been few cases where a "mutual" mistake (where the parties are at cross-purposes) has been held operative. The reason for this is that if B accepts A's offer based on a misunderstanding, this will normally be because B has carelessly misunderstood the offer, in which case B will suffer the consequences *or* because A has framed his offer ambiguously (in which case either A will bear the loss or the court will find the agreement insufficiently certain to amount to a contract). Where an operative mutual mistake *is* present, the case could equally well be determined on the basis of offer and acceptance principles.

"Unilateral" mistakes are operative only where one contracting party is aware of the other's mistake. As such, they generally involve fraud on the part of the non-mistaken party. The solution is, normally, to find that such agreement is voidable on the grounds of misrepresentation rather than void for mistake. Again, of course, "mistake", as such, is redundant. Those cases which have determined that the contract is void for unilateral mistake have invariably been the subject of criticism, not least on the basis that they have produced injustice to an innocent third party.

Despite the above, there are sufficient leading cases based on a finding of mistake to conclude that, whether or not mistake *should* stand alone as a separate doctrine, in practice it does so. Before embarking on an analysis of the law of mistake, however, it should be noted that the issue of mistake only becomes relevant if the contract itself does not readily identify and allocate to the parties responsibility for mistakes. This has been recognised in a number of cases such as *William Sindall plc v Cambridgeshire CC*.[9] If, for example, a contract makes clear that a "buyer" is

7. (1950) 84 CLR 37.
8. See *Couturier* case at 10.3 below.
9. [1994] 3 All ER 932, in which Hoffmann LJ quoted Steyn J in *Associated Japanese Bank (International) Ltd. v Credit du Nord SA* [1988] 3 All ER 902: "Logically, before one can turn to the rules as to mistake, whether at common law or equity, one must first determine whether the contract itself, by express or implied condition precedent or otherwise, provides who bears the risk of the

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Duress and Undue Influence

Overview

Duress is illegitimate pressure put on a person to enter into a contract. It is a vitiating element recognised at common law. It can be divided into duress of the person, duress of goods and economic duress. The law has had no problem with setting aside contracts in the first category. The last category is relatively recent and has, to a large extent, overtaken duress of goods. Economic duress occurs where some unfair and unlawful economic pressure is placed on a party to a contract. While it may sometimes be difficult to distinguish between duress and legitimate, hard bargaining, the key elements of economic duress are "illegitimate pressure" and lack of a practical alternative.

Operative duress renders a contract voidable. The contract will not terminate automatically but continue in existence until the innocent party exercises his option to rescind the contract. However, the exercise of this power of rescission is, as is the case with misrepresentation,[1] subject to certain bars in respect of undue delay (lapse of time), affirmation of the contract by the innocent party, and the acquisition of an interest by an innocent third party.

The equitable counterpart of duress is the doctrine of undue influence. The term "undue influence", while not statutorily defined, relates to those situations where the courts are prepared to intervene on behalf of a weaker party because pressure has been used, of a more subtle nature than previously recognised by the doctrine of duress, to persuade a party to enter into a contract. This pressure arises because of the nature of the relationship between the parties which places one party in a dominant position over the other. As the concept of duress has broadened, the original rationale for undue influence has become less significant and there are now cases in which duress and undue influence are pleaded as alternatives and where the court could decide on either basis.

Undue influence may be divided into two categories: actual undue influence and presumed undue influence. In the former category the complainant has the burden of proving undue influence; once proved, however, the agreement is automatically

1. See chapter 9.

rendered voidable. There is no requirement here that the influenced party show the agreement to be disadvantageous to him.[2]

In the latter category, "presumed" undue influence, the relationship between the parties is such that one party has put "trust and confidence" in the other (dominant) party. When this relationship of trust and confidence has been established, and the agreement entered into "calls for explanation", the transaction will be voidable *unless* the dominant party can prove that no undue influence was in fact exercised. In other words, the courts "presume" the exercise of undue influence in these cases but the presumption can be, in legal terminology, "rebutted". The dominant party will normally rebut the presumption by showing that the weaker party relied primarily on independent legal or financial advice in making the agreement in dispute.

The relationships giving rise to the presumption of undue influence are generally further subdivided into two groups. The first group arises from a "special relationship" between the parties, such as that between a trustee and a beneficiary, a guardian and a ward, a parent and a child. In these cases, there is an irrebuttable presumption that a position of influence *exists* (but not that it has been *exercised* unduly). In other words, the dominant party cannot deny the existence of such a position of influence. The second group is based not on a special relationship but on proof that, *in the circumstances*, one party was in a position to exert influence over the other because that other had put himself entirely into the hands of the "influencer". So, for example, there is no special relationship between husband and wife *but* it may be possible for one of them (usually the wife) to convince the court that she has put her legal matters entirely into the hands of her husband such that the existence of a position of undue influence can be presumed.

It must be emphasised that, contrary to the views expressed in some older precedents, the existence of a position of presumed undue influence will not, by itself make a contract voidable (unless the dominant party proves the agreement was made by the weaker party's own free will). It must *also* be shown that there is something about the agreement which "calls for an explanation" (this more recent expression has now replaced the old rule that the agreement must be "manifestly disadvantageous" to the weaker party). So, for example, while there might be a special relationship between parent and child, the courts will not intervene merely because a child has bought a parent a small Christmas present; it is not unusual so does not call for an explanation.

The effect of undue influence on a third party has been the subject of much recent debate and major judicial decisions in England and Hong Kong. Traditionally, a third party would be unaffected by the undue influence of another unless that other was acting as agent for the third party in exerting the influence or, at least, the third party had knowledge of the undue influence. So, by analogy with most "mistaken identity" cases,[3] where property is obtained from A by the undue influence of B and

2. *CIBC Mortgages Plc v Pitt* [1993] 4 All ER 433.
3. See 10.5.2.

then disposed of to C prior to rescission, the right to rescind will be lost unless B was acting on C's behalf or C bought the property in bad faith.

The "traditional" limitations have been amended considerably in respect of those transactions where the "influencer" persuades the "influenced" to deal directly with a third party, usually a bank, lender or similar institution. Here, where the transaction is such that it "calls for an explanation" and is "non-commercial", the bank, or similar, should be "put on inquiry" as to the possibility that the agreement made was affected by undue influence (or misrepresentation). This does not mean that such agreements can automatically be set aside as against the third party but it does mean that the third party is required by law to take certain steps to advise the possibly-influenced party of the implications of the transaction for him (or usually her). The leading decision in this area, and indeed on undue influence as a whole, is the House of Lords case of *Royal Bank of Scotland Plc v Etridge (No 2)*.[4]

Etridge also reviewed the steps that a third party, usually a bank, should take to discharge its obligations in such cases and avoid liability. The steps that the third party should take are of a practical nature but essentially require that the innocent party be given the opportunity to have independent legal advice before entering into the contract.

Hong Kong courts have applied the findings in *Etridge* in subsequent cases. Lord Scott, who sat in the House of Lords in *Etridge*, also sat as a non-permanent judge in the Court of Final Appeal case of *Lo Sau Ying v Bank of China (HK) Ltd*,[5] the most important Hong Kong case to date on undue influence involving a third party. The Hong Kong Law Society has also issued guidelines on solicitors' duties in relation to security transactions with a potentially unduly influenced party in the light of *Etridge* and subsequent local decisions.[6]

Undue influence, like misrepresentation and duress, renders the contract voidable. This means it can be rescinded by the influenced party provided that none of the recognised "bars" to rescission exist, such as undue delay or the acquisition of an interest by an innocent third party. However, since undue influence is a product of equity, "a court of conscience", the court may allow the "influencer" to retain some of the benefits of the contract where it appears just to do so.

11.1 Duress

Duress is a common law doctrine which renders voidable[7] a contract entered into as a result of improper pressure. The pressure must have been a significant cause of the "coerced" party making the impugned contract. Traditionally, this pressure

4. [2002] 1 AC 773.
5. [2005] 1 HKLRD 106.
6. "Guidelines on solicitors' duties in relation to security transactions with potentially unduly influenced party" (issued 19 March 2003).
7. While there were previous judicial statements that duress made an agreement "void", *voidability* is now clearly accepted (see *Mir v Mir* [2013] 4 HKC 213 and discussion of *The Atlantic Baron* below).

12

Unconscionability

Overview

The vitiating elements of duress and undue influence are sometimes viewed as two aspects of a more general element of "unconscionability". However, it is necessary to treat unconscionability separately, especially in Hong Kong, since legislation has intervened, in the form of the Unconscionable Contracts Ordinance (UCO)[1] and because, outside the scope of the legislation, there remain instances where neither duress nor undue influence would apply but where the Hong Kong courts have found a contract to be tainted by unconscionability. What also distinguishes unconscionability from other vitiating elements such as mistake, misrepresentation and undue influence is the need for some malfeasance on the part of the defendant. Such malfeasance *may* be present in the case of these other elements but it is not a *requirement*. Unconscionability, on the other hand, requires both a "disability" and knowledge thereof on the part of the defendant.

In this area the law of Hong Kong differs explicitly from English law. In English law, recognition of unconscionability is limited to a few specific cases such as unconscionable agreements made in anticipation of an inheritance and unconscionable dealings with "poor and ignorant" persons. There is no general recognition of a broad category of unconscionability. However, on occasion, notably in *Lloyd's Bank Ltd v Bundy*,[2] previous Master of the Rolls Lord Denning suggested that, as a general principle, contracts could be set aside on the basis of "inequality of bargaining power". This approach has not been generally accepted by the judiciary and the view has more often been expressed that such an approach would lead to uncertainty and that if there is to be change it should be via legislation. At present no English legislation has been introduced relating *directly* to unconscionability.

New legislative rules dealing *indirectly* with unconscionability were, however, enacted in England in the form of the Unfair Terms in Consumer Contracts Regulations (UTCCR), 1994.[3] These Regulations were a response to a European

1. Cap 458.
2. [1975] QB 326, [1974] 3 WLR 501, [1974] 3 All ER 757.
3. Amended by UTCCR 1999 and now replaced by the Consumer Rights Act 2015; see 8.6.

Community Council Directive and were directed at "unfair" terms in contracts for the sale or supply of goods or services where one party deals as a consumer and where the term is not "individually negotiated". "Unfairness" and "unconscionability" are, of course, not synonymous. However, since the Regulations defined the unfairness of a term as being "contrary to the requirement of good faith" and causing "a significant imbalance in the parties' rights and obligations", there was clearly a close connection between unfairness under the Regulations and Lord Denning's concept of unconscionability. The Regulations did not permit the amendment of unfair terms; the terms were merely "not binding" on the consumer.

In Hong Kong, on the other hand, the UCO permits courts to rewrite contracts. The Ordinance, passed in October 1994, and in force one year later, is modelled on Australian legislation, and gives courts wide powers on finding that a contract is unconscionable. However, the Ordinance is, importantly, restricted to contracts involving the sale of goods or supply of services[4] where one party deals as a consumer. At this stage it is too early to tell how far the Hong Kong courts will go in using the powers, clearly spelled out in the Ordinance, to amend contracts.

Because of the limitations on statutory unconscionability in Hong Kong, the common law rules remain important and it is now clear that cases may be determined on the basis of unconscionability which are outside the scope of the legislation.

12.1 Statutory Unconscionability in Hong Kong

The UCO, based largely on Australian legislation, received assent on 20 October 1994. It reflects a trend in Hong Kong away from a non-interventionist approach towards increasing interference in the market and statutory consumer protection. Nonetheless, it is unlikely to be of great significance given that it is limited in scope and, at the same time, overlaps with existing common law and statutory rules

12.1.1 Background to the Legislation

The enactment of the Ordinance followed a Report by the Law Reform Commission of Hong Kong (LRC)[5] which considered legislation in various common law jurisdictions and recommended that:

> a provision such as section 52A of the Australian Trade Practices Act (dealing with unconscionable contracts) be adopted in sale of goods and supply of services in Hong Kong.[6]

4. Because the terms of reference of the Law Reform Commission of Hong Kong, on whose recommendations the Ordinance was based, were so restricted.
5. Report on Sale of Goods and Supply of Services (Topic 21).
6. Ibid at para 7.7.5.

13

Illegal Contracts

Overview

The courts will generally not permit the enforcement of a contract which is illegal. A contract is illegal if its creation or performance is prohibited at common law, by public policy or via legislation.

Although writers sometimes disagree about classification,[1] it is generally agreed that the category of illegal contracts includes those contracts described as illegal by statute, such as gaming or wagering contracts, and those illegal at common law on the grounds of public policy, such as contracts to commit crimes or torts, contracts to promote sexual immorality, contracts to oust the jurisdiction of the courts, and contracts in restraint of trade. Of the long list of contracts illegal by statute, common law or public policy, the most significant, in the Hong Kong context, are those concerning gambling contracts and restraint of trade. In this chapter we will list the major types of illegal contract but focus in depth only on gambling contracts and those in restraint of trade.

While it is often a simple task to determine if a contract is illegal under statute, "public policy" is an elusive concept, since it is not defined by statute and depends on the views of judges as to what is publicly acceptable. Naturally, over time, as public attitudes change, "public policy" will change accordingly. One category of contract illegal under common law is that involving the promotion of "sexual immorality". It is, of course, the case, that views on sexual immorality may vary considerably, even in a single jurisdiction, over time.

In determining the effects of illegality the courts have to take into account two competing propositions. The first is that if a party has taken the benefit of a contract, even an illegal one, he should recompense the other party, otherwise he will be unjustly enriched. The second is that no party should be allowed to base an action on his own improper or illegal conduct: the so-called *ex turpi causa* principle. In general, the courts endorse the second proposition and prevent a party who has acted

1. "Illegal contracts come in so many different shapes and sizes that it is difficult to find an appropriate classification for all the cases . . . No two commentators appear to adopt the same classification": E. McKendrick, *Contract Law: Text, Cases & Materials* (Oxford: Oxford University Press, 2017), p 338.

illegally from suing under the contract, even though this results in an "unfair" benefit to the other party. The prime consideration of the courts is that illegal contracts should be discouraged by preventing their enforcement. The principle is enshrined in the Latin maxim *in pari delicto melior est conditio defendentis* (*in pari delicto*) which means that where both parties are equally at fault the court should favour the defendant. The motivation is not protection of the defendant but the indirect benefit to the public which results from the discouragement of illegal practices. There are, however, exceptional cases where the courts assist a plaintiff who has knowingly made an illegal contract.

Judges, in deciding the outcome of illegality cases, often draw a distinction between contracts which are illegal as *formed* and those illegal as *performed*. Thus, for example, a contract to jointly rob a bank and then divide the proceeds is obviously illegal as formed. On the other hand, a contract under which A agrees to ship B's goods is not, on the face of it, illegal but may be performed illegally if A decides to overload the ship contrary to law.

Generally, when contracts are illegal as formed, the courts refuse to allow enforcement by either party. However, they may allow limited enforcement of an illegally formed contract via the "severance" of the part that is illegal.

When, however, the contract is illegally performed, the courts tend to permit enforcement by an "innocent" party (ie one who has not performed illegally) but not by the guilty. On rare occasions, even the guilty party may be allowed to enforce the contract if his action can be asserted without reference to the illegality of the contract.[2]

At common law, many types of gambling were lawful. Most, however, are unlawful in Hong Kong on the grounds of public policy or under statute. The Gambling Ordinance[3] makes most forms of gambling unlawful with only limited exceptions. Gambling includes gaming, bookmaking and "wagering" (betting).

Contracts in restraint of trade, a very important phenomenon in Hong Kong, are in some ways distinct from other illegal contracts in that the restraint is only "presumed" to be void. If it can be shown to be reasonable in the interests of the parties and the public, it will be upheld. Moreover, it is only the restraint which is void and it may be possible to enforce the rest of the contract without the restraint via the severance doctrine.

13.1 Types of Illegal Contracts

The list of illegal contracts is extensive and only the more significant types will be listed. With the exception of gambling contracts and contracts in restraint of trade, the forms of illegal contract will be listed with little further discussion.

2. See *Bowmakers Ltd v Barnet Instruments Ltd* [1945] KB 65, [1944] 2 All ER 579.
3. Cap 148.

14

Termination of Contracts

Overview

A contract may be terminated in one of four different ways: by agreement; by performance; via breach; and by the operation of law, principally through frustration.

Termination by *agreement* is usually a simple process as the parties are free, if they so wish, to end the contract. Consideration[1] may, however, be a problem in relation to termination by agreement. When both parties still have outstanding obligations and agree to terminate, no consideration problem arises since each confers a benefit on the other; namely, the avoidance of further obligation. However, there is a consideration problem where X, having completely discharged his obligations under the contract, agrees to release Y from his (Y's) outstanding obligations. There is "accord" (agreement) but no "satisfaction" (consideration). The rule is that there must be both accord *and* satisfaction. The rule that an agreement to accept part payment of a debt in full satisfaction is not binding (the rule in *Pinnel's* case),[2] is an illustration of the accord and satisfaction rule.

The general rule regarding termination by *performance* is that a party's contractual obligation is not discharged until performance is complete; before performance is completed there is no right to payment under the contract: *Cutter v Powell*.[3] There are, however, some notable exceptions to this rule. First, one party may accept partial performance by the other. In this case, provided that the acceptance is freely given, there will be a requirement to pay for the accepted performance. This will not be the full contract price but a reasonable amount for what has been done, a *quantum meruit*. Second, reasonable payment may be awarded where the reason for non-completion is that the other party has prevented full performance. Third, a *quantum meruit* may also be possible if the court decides to treat a contract as "divisible" rather than entire. The courts, though, are somewhat reluctant to divide a contract[4] unless such is clearly seen to be intended by, for example, provision for "staged

1. See chapter 4.
2. [1602] 5 Co Rep 117a.
3. [1795] 6 TR 320.
4. Treitel (op cit) argues that it is "obligations" rather than contracts themselves which may be divisible (see discussion at 14.2.1.2 below).

payments". Finally, the doctrine of "substantial performance" may be applied by the courts. Substantial performance occurs where a contract is almost completely performed, except for minor defects or omissions. Here there is a right to the contract price although the other party will be entitled to make deductions for the cost of remedying the defects or omissions.

Breach of contract may result in the termination of a contract but only if the breach involved is a serious one and the innocent party chooses, or "elects", to exercise his right to cancel, or "repudiate", on the grounds of serious breach. Breach of a condition will automatically permit the innocent party to make an election. Breach of an "innominate" term may also entitle the innocent party to such an election but only if the consequences of breach are serious enough. Breach of a mere warranty only entitles the innocent party to claim damages, but does not give him the choice of terminating the contract.[5]

A contract may be terminated by *frustration* where "the further fulfilment of the contract is brought to an abrupt stop by some irresistible and extraneous cause for which neither party is responsible."[6] Although frustration is not statutorily defined it is clear, from the cases, that the doctrine only applies to the most extreme events (making performance effectively impossible) occurring *after* the contract is formed, for which neither party is responsible and which the parties neither provided for in the contract nor foresaw. Typical frustrating events include subsequent destruction of the subject matter of the contract, subsequent illegality of the contract and the subsequent destruction of the fundamental purpose of the contract. Frustration may provide the basis of a claim for compensation, or be pleaded simply as a defence against an action for breach by the other party to the contract. In either case the plea is more likely to succeed if made by a consumer than by a commercial party.

The *consequences* of frustration (though not its definition) are governed by legislation. The most important provisions are in section 16 of the Law Amendment and Reform (Consolidation) Ordinance (LARCO),[7] which is essentially based on the corresponding English legislation.[8] The legislation permits the courts considerable discretion in determining how loss should be apportioned in the event of frustration.

14.1 Termination by Agreement

If both parties decide they wish to bring their contract to an end, they are free to do so. There are usually few difficulties with this but problems can arise in relation to consideration. Where each party still has obligations to perform—that is the agreement is still "executory" on both sides—there is no consideration problem. Each

5. See 8.5 for further discussion of classification of terms.
6. M. Furmston, *Cheshire, Fifoot & Furmston's Law of Contract* (Oxford/New York: Oxford University Press, 17th edn, 2015), p 712
7. Cap 23.
8. Law Reform (Frustrated Contracts) Act 1943.

15

Remedies for Breach of Contract

Overview

The most important remedy for breach is the common law remedy of damages. Damages are available "as of right" which means that, wherever there is a breach, the innocent party is automatically entitled to damages. There is no need to prove loss, but without loss, damages will be merely "nominal".

In order to establish the right to "substantial" (as opposed to nominal) damages, the plaintiff must show that the defendant's breach actually "caused" his loss, and, more significantly, that the loss suffered is not too unlikely, or "remote", a consequence of the breach. Causation is rarely a problem in contract cases, particularly since it is established that, where the defendant's breach is *one* of the causes of the plaintiff's loss, he can be liable to the plaintiff.

"Remoteness" is more often encountered as a problem in contract. The rule of remoteness, deriving from the decision in *Hadley v Baxendale*,[1] as refined by later decisions, is that the defendant is liable for the "natural and probable" consequences of his breach; a more restrictive test than that in the tort of negligence where the defendant is liable for all the "reasonably foreseeable" consequences of his negligence. A variation on *Hadley* suggested by Lord Hoffmann[2] in *"The Achilleas"*[3] has found little support in England but has found favour in Hong Kong.[4]

The purpose of contract damages is always to *compensate*. Thus, the court focuses on the loss to the plaintiff and not the gain to the defendant. The "measure" of damages in contract is usually assessed on the basis of "loss of bargain"; putting the plaintiff in the position he would have been if the other party had fulfilled his obligations. On occasion, the alternative measure of "reliance loss" is applied, based on the expense incurred by the plaintiff in reliance on the defendant completing his side of the bargain. In measuring damages, the courts are assisted by a number of specific rules such as the "market rule", in sale of goods contracts, and the rules on mitigation and liquidated damages. As to the latter, significant developments have

1. (1854) 9 Exch 34.
2. The "assumption of responsibility" test.
3. [2009] AC 61.
4. See 15.1.2 below.

occurred in English law. It remains to be seen whether Hong Kong law will mirror the changes.

Equitable remedies are available only at the discretion of the court. Although this discretion is absolute, a number of recognised factors influence its exercise. First, since equity developed, historically, to remedy the defects in the common law, equitable remedies are available only where the common law remedy of damages is inadequate. Second, since equity developed as a "court of conscience", an equitable remedy will only be granted where it is "just and equitable" in all the circumstances. In deciding whether it is "just and equitable" to intervene on a party's behalf, equity will take into account the so-called "maxims" of equity: such as that "he who comes to equity must come with clean hands" and "he who seeks equity must do equity".

The major equitable remedies in contract are specific performance and injunction. Specific performance is an order that a party must fulfil his contractual obligations rather than simply pay damages for breach. Specific performance will only be awarded where monetary compensation is inadequate such as in contracts for the sale of land and contracts for the transfer of something unique. Specific performance will not be awarded for a personal service contract and is unlikely to be awarded where enforcement would require constant supervision by the court. Further, under the principle of "mutuality" specific performance will not be awarded to a party to a contract, if it could not be awarded against him, as, for example, in the case of a minor.[5]

Injunctions, unlike specific performance, are not an exclusively contractual remedy. In contract, injunctions are used to enforce *negative* undertakings, express or implied. Where a negative undertaking has already been broken a mandatory injunction will be required to undo the improper breach; where the plaintiff merely fears that the undertaking is *about to be* broken, a prohibitive injunction will be sought to prevent the threatened breach taking place.

In the case of equitable remedies, the ultimate sanction, in the event of a failure by the defendant to comply, is the imposition of punishment for contempt.

While it may be thought that the distinction between common law and equity is largely obsolete, given that all courts may award both common law and equitable remedies, the distinctive nature of equity remains important given that equitable remedies continue to be available only at the discretion of the court, and that courts exercising an equitable jurisdiction continue to grant remedies so as to produce a "just and equitable" result

It should also be remembered that the "common law" to which Hong Kong adheres, and which will remain in force (at least) until the year 2047, includes the principles of equity.[6]

5. See 6.3.1.
6. See chapter 2.

16

Privity of Contract

Overview

The doctrine of privity of contract states that "no one . . . may be entitled to or bound by the terms of a contract to which he is not an original party."[1] There are two separate aspects of the doctrine: that third parties cannot acquire rights under a contract *even if the contracting parties so intend*; and that third parties cannot have obligations imposed upon them by a contract. The doctrine is a creation of the common law. As with many common law rules, its rigidity has clashed with the needs and theories of different areas of law such as land law.

The doctrine has been a central, if controversial, part of English and Hong Kong contract law for a considerable period. A fundamental rationale for the doctrine is that contract is said to be based on "agreement" and third parties are generally not part of ("privy to") the contractual agreement. A further reason for the doctrine is that third parties should not be able to sue for breach of contract in the absence of consideration.[2] Another is that, as contract is based on the concept of consent, a third party, who has not given any consent, should not be able to obtain any contractual rights. A third rationale is that if a third party were able to enforce a contractual promise, the promisor could be sued by both the promisee and the third party. A fourth justification is that it would be unfair for a third party to be able to sue on a contract but not be sued.[3] Finally, it is said, the doctrine preserves the contracting parties' right to rescind or vary the contract which would be more difficult were a non-party to have contractual rights.

However, there are strong arguments against the doctrine. These are aimed largely at the first aspect of the doctrine; that is, a third party cannot acquire and enforce rights or benefits under a contract. The second aspect of the doctrine, that a third party cannot be made liable under a contract, is generally regarded as just and sensible. The strongest of the arguments against the first aspect of the doctrine is that

1. M. Furmston, *Cheshire, Fifoot & Furmston's Law of Contract* (Oxford/New York: Oxford University Press, 17th edn, 2015) at p 556.
2. See chapter 4.
3. But such one-sided liability is inherent in all "unilateral" contracts: see, for example, *Carlill* case and 3.3.4 above.

it frustrates the intentions of the parties to a contract which is made expressly for the benefit of a third party. A second reason is that the doctrine is complex, uncertain and artificial. This is reflected in the courts having recourse to such devices as agency and the trust to allow a third party to obtain a benefit under a contract. Also legislation has made partial inroads into the doctrine. This has caused the law of contract to become complex and artificial. The very fact that the courts and the legislature have felt it necessary to take such steps indicates that the doctrine causes injustice in some instances. Thirdly, the doctrine means that a third party who has suffered loss of an intended benefit under the contract cannot sue, while the party to the contract, who has suffered no loss, can sue (though probably only for nominal damages).[4] Finally, injustice will result if a third party has relied on the promise and acted to his detriment and cannot sue on the contract.

The reasons given above have resulted in legislation being enacted in England, elsewhere[5] in the common law world and, finally, in Hong Kong. The Law Reform Commission of Hong Kong produced a Report calling for significant reform as long ago as 2005, but only 11 years later was resulting legislation finally in force. The common law rules on privity remain significant, however, since the legislation specifically does *not* affect common law restrictions on the privity doctrine. Moreover, the new legislation permits parties to a contract to exclude the operation of the new legislation; in which circumstance, of course, the common law rules will be crucial.

16.1 The Doctrine of Privity of Contract

The common law doctrine of privity of contract establishes that only the parties to a contract can sue and be sued on it: it can neither confer rights nor impose liabilities on others.[6] The doctrine has existed in English law since the middle of the nineteenth century when it was firmly established in *Tweddle v Atkinson*.[7] The doctrine was later reaffirmed by the House of Lords in *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd*.[8]

The second aspect of the doctrine—that contractual liabilities should not be imposed on third parties—has not provoked controversy. It is the first aspect which has proved to be controversial. Even if the parties clearly intended by contract to confer a right on a third party, English and Hong Kong law stated that they could not do so. It is this part of the doctrine which has been addressed and reformed by the English legislation.

4. See discussion of *Jackson* and *Woodar* at 16.2.4 below.
5. Such as Australia (in the states of Northern Territory, Queensland, and Western Australia), New Zealand, and Singapore.
6. See, for example, E. Martin, *A Concise Dictionary of Law* (Oxford: Oxford University Press, 5th edn, 1990).
7. (1861) 1 B&S 393.
8. [1915] AC 847.