Chapter 2

# Abortive Negotiations and the Pre-formation Stage

CONTENTS



## (1) Introduction[1]

**2.01** Intricate rules govern the pre-contractual context. Readers hoping to find a single formula, such as a pre-contractual duty to negotiate in good faith, will find Hong Kong contract law lacking in such simplicity. The Hong Kong courts have followed the English courts in using a 'Swiss army knife' for this purpose, rather than a single blade. But Hong Kong contract law is not allergic to notions of pre-contractual fair dealing or responsibility for culpable or bad faith rupture of negotiations. On the contrary, as we shall see in this chapter, Hong Kong contract law can sometimes energetically intervene to correct an injustice in this pre-contractual context.

**2.02** The principle of freedom of contract (**1.05**) permits negotiating parties to 'walk away' from a proposed deal, provided they have not already committed themselves to a binding agreement. In the absence of a binding contract, a person's performance (for example, delivery at the other party's request of goods) can give rise to a restitutionary obligation to pay the reasonable market value of the relevant performance (**2.04**ff). In this situation, the law is presently defective because it does not allow the recipient of the relevant performance to require the court to

[1] E McKendrick, in W Cornish and others (eds), *Restitution: Past, Present and Future* (Hart, 1998) ch 11; Michael Spence, *Protecting Reliance: The Emergent Doctrine of Equitable Estoppel* (Hart, 1999) 87–106; D K Allen, 'Pre-contractual Liability' in J Gardner (ed), *UK Law in the 1990s* (CUP, 1990) 90ff; J Dietrich, 'Classifying Precontractual Liability: A Comparative Analysis' (2001) LS 153–91; R Zimmermann and S Whittaker (eds), *Good Faith in European Contract Law* (CUP, 2000) 236–57; P Giliker, *Pre-contractual Liability in English and French Law* (Kluwer, Dordrecht, 2002); P Giliker,



reduce the award to reflect the other party's slow performance. An agreement to agree the primary contract is not legally binding, nor an agreement to bargain in good faith to reach the primary agreement, nor an undertaking to use best or reasonable endeavours to conclude the same (**2.10**ff). However, a 'lock-out' agreement is binding, if there is consideration to support it (**2.14**). Therefore, an undertaking not to deal with third parties during a specified period (a fixed period, not a 'reasonable' period) is binding. Such a 'lock-out' agreement grants exclusive bargaining rights during the specified period. The courts also uphold agreements to use reasonable or best endeavours to procure a third party's permission, such as planning permission, provided this agreement is supported by consideration (**2.15**). Finally, an agreement to mediate is binding *to the extent* that a party cannot proceed straight to litigation without honouring the obligation to respect the mediation stage (**2.18**).

## (2) Abortive Negotiations

**2.03** Freedom of contract involves freedom not to contract. As Lord Ackner said in *Walford v Miles* (1992):[2]

> Each party to [pre-contractual] negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations. To advance that interest he must be entitled, if he thinks it appropriate, to . . . withdraw [with impunity][3]

Some civil law jurisdictions police this zone using general principles of good faith or fair dealing, or a wide notion of *culpa in contrahendo* (fault during the process of bargaining). For example, Israeli law does so using the principle of good faith, drawing upon German law.[4] But the Hong Kong courts, like the English courts have not articulated a general doctrine of fault in bargaining (*culpa in contrahendo*),[5] nor a general doctrine of good faith negotiation (but, in the context of tenders, a duty of fair dealing has been articulated, **3.27**ff). However, the pre-contractual zone is not a lawless jungle, even in England. Traditionally, Hong Kong lawyers regard the concept of 'good faith' (**1.10**ff) as unattractively vague. Instead, Hong Kong contract law uses a mix of common law and equitable doctrines to protect a party to negotiations. As we shall see, Hong Kong contract law can intervene to prevent unjust enrichment, or to remedy deceit or other unfair dealing. Gathering together the threads of this topic, Aikens LJ in the *Barbudev* case (2012) made this helpful summary:[6]

> (1) it is for the parties to decide at what stage they wish to be contractually bound . . . the parties are 'masters of their contractual fate'.[7] (2) They can agree to be bound contractually, even if there are further terms to be agreed between

[2] [1992] 2 AC 128, HL.

[3] See also Art 28, Contract Law of the Dubai International Financial Centre: http://www.difc.ae/laws_regulations/index.html.

[4] N Cohen in J Beatson and D Friedmann (eds), *Good Faith and Fault in Contract Law* (OUP, 1995) 32.

[5] P Giliker, 'A Role for Tort' (2003) 52 ICLQ 969.

them.[8] (3) The question is whether the agreement is unworkable or fails for uncertainty. (4) However, where commercial men intend to enter into a binding commitment the courts are reluctant to conclude that such an agreement fails for uncertainty.[9] (numbering added)

**2.04** *Unjust Enrichment or Restitutionary Relief:* The main source of relief in Hong Kong law for a person who has lost out because a deal has not been concluded is to seek protection within the law of unjust enrichment. In the *British Steel* case (1984) Goff J held that there was no contract because there had been a failure of offer and acceptance.[10] The claimant had delivered a large number of special 'steel nodes' for use by the defendant in constructing a building. Eventually all the nodes had been supplied. But the defendant contended that these goods had been delivered both slowly and in the wrong sequence (although Goff J said that he was not satisfied that these complaints were justified as a matter of fact). The defendant further contended that this alleged delay had caused loss because the project had not been completed on time. The dispute concerned both the main claim for payment (the market value of the goods was £229,832), and a counterclaim against the claimant for compensation in respect of the defendant's commercial loss caused by the alleged slow and haphazard delivery of these materials (£867,735).

**2.05** Goff J found that there were two reasons why no contract had arisen: first, the parties had yet to agree precise terms concerning possible liability for consequential loss (for example, because of slow delivery); secondly, the parties had not fixed the price.[11] For either reason, he held that offer and acceptance had not been satisfied. Goff J also held that it made no difference that a letter of intent had been issued.[12]

**2.06** Despite finding that no contract had arisen in this case, Goff J awarded the claimant the market value of the goods (£229,832), on the basis of the law of restitution, an extra-contractual cause of action.

**2.07** As mentioned, Goff J said that he was not satisfied that the defendant's complaint concerning delay was justified as a matter of fact. But, even if there had been culpable delay by the supplier, Goff J would not have been able to award contractual damages to compensate the defendant for any loss consequent on this delay, for such a counterclaim would require the judge to have found that the parties had formed a contract. And so the *British Steel* case (1984) vividly illustrates that

[8] *RTS Flexible Systems Ltd v Molkerei Alois Müller GmbH* [2010] 1 WLR 753 at [48], *per* Lord Clarke: 'In the Pagnan case . . . [the] parties agreed to bind themselves to agreed terms, leaving certain subsidiary and legally inessential terms to be decided later.'

[9] *Hillas v Arcos Ltd* (1932) 147 LT 503, 514 *per* Lord Wright.

[10] *British Steel Corpn v Cleveland Bridge and Engineering Company* [1984] 1 All ER 504; S Ball, 'Work Carried Out' (1983) 99 LQR 572; E McKendrick (1988) 8 OJLS 197, at 212, 215, 217; A Burrows, *The Law of Restitution* (3rd edn, OUP, 2011) 373–78.

[11] [1984] 1 All ER 504, 509–11, *per* Goff J.

[12] Even if the arrangements remain evidenced by a letter of intent, a valid construction contract might



restitution can be a rather second best solution in this pre-contractual context, where both parties have a grievance: for restitution might confer victory on the supplier, who recovers the full market value of the goods supplied; but no victory for the defendant, whose compensation claim fails against the recipient in respect of the latter's slow performance. In short, the restitutionary award is asymmetrical, because relief operates only in favour of the performer.

**2.08** A possible solution to the problem in the *British Steel* case is to reduce the amount of the claimant's restitutionary claim to reflect the fact that performance was slow. But even if this were possible, on the facts of *British Steel* this approach would have achieved an imperfect result: for the value of the counterclaim (c £868,000) would have greatly exceeded the reasonable value of the goods supplied (c £230,000).

**2.09** Perhaps a neater solution might have been to find a contract despite the parties' failure to agree on all the terms. Some commentators have contended that the courts might adopt a more flexible approach to finding a contract. This would provide a solution to such problems. For example, Ball (1983) suggests that businesses would find this an attractive approach.[13] However, the objection to this approach is that it would offend the principle of freedom of contract (**1.05**). That principle requires that negotiating parties must not be treated as having reached final agreement if they have yet to finalise negotiations on crucial matters: that they should not be steam-rollered into contracts. As explained at **2.05** above, Goff J decided that the parties in the *British Steel* case had clearly not settled major difficulties in their negotiations, but had decided to proceed in the hope that a final contract would take shape later. However, it might be possible in some situations to impose a contractual solution on the basis that the parties' dealings *have implicitly overridden the negotiation snag*. The *British Steel* case was arguably borderline in this respect.

For example, the Supreme Court of the United Kingdom in *RTS Flexible Systems Ltd v Molkerei Alois Müller GmbH* (2010)[14] held that a contract had arisen even though the parties had initially contemplated (using the 'subject to contract' formula, **4.33 and 8.09**) that they would only enter a contract on finally concluded terms and would signify that ultimate agreement by formal signing. In essence, machinery had been installedunder a letter of intent, while detailed negotiations continued. In due course the negotiations had ended perfectly but there had been no formal signing (as contemplated) of the contract. Tthe Supreme Court of the United Kingdom held that this was a case of active dealings, involving substantial work, being initially 'subject to contract' but becoming a fully-fledged implied contract; and this metamorphosis should be rationalised as the parties' manifesting by conduct an intention to waive the 'subject to contract' understanding. It is submitted that the Supreme Court of the United Kingdom were right both to find

[13] S Ball, 'Work Carried Out' (1983) 99 LQR 572; similarly, O'Sullivan and Hilliard (eds), *The Law of Contract* (7th edn, OUP, 2014) ch 5.

an implied contract[15] on these facts and, in reaching that decision, to recognise the possibility that the formula 'subject to contract' can be waived, that is, overridden by the parties' dealings. However, this will be rare. As Lord Clarke emphasised, at paragraph 56 of his judgment, there must be very clear evidence of such a waiver.

### (3) Negotiation Agreements

**2.10** In *Walford v Miles* (1992), the House of Lords held that an agreement to negotiate in good faith or reasonably is uncertain and void.[16] The main reasons are: the requirement to bargain in good faith (or reasonably) is too vague; and the courts would otherwise become embroiled in complicated inquiries into the reasons why negotiations had broken down. Such a wide-ranging and nebulous obligation would embroil the courts in complicated inquiries into the reasons why negotiations broke down. It is submitted that a bare agreement to negotiate in good faith or reasonably is rightly condemned as fatally void for uncertainty. Adjudication of such a 'commitment' would be drenched with subjectivity and commercial value judgments. It is submitted that *Walford v Miles* was correctly decided.

In the following seminal passage Lord Ackner said that an agreement to agree, or to negotiate in good faith, or reasonably, or for a reasonable period, is void for uncertainty because the court is faced with a vacuous obligation which lack content; 'reasonably' or 'in good faith' are hopelessly vague criteria; and so the court or arbitral tribunal cannot adjudicate reliably upon an allegation that there has been a breach:[17]

> The reason why an agreement to negotiate, like an agreement to agree, is unenforceable, is simply because it lacks the necessary certainty . . . How can a court be expected to decide whether, subjectively, a proper reason existed for the termination of negotiations? . . . [How] is a vendor ever to know that he is entitled to withdraw from further negotiations? How is the court to police such an "agreement?" . . . [While] negotiations are in existence either party is entitled to withdraw from those negotiations, at any time and for any reason. There can be thus no obligation to continue to negotiate until there is a "proper reason" to withdraw. Accordingly a bare agreement to negotiate has no legal content.

**2.11** There is no doubt that *Walford v Miles* (1992) (see preceding paragraph) remains a cornerstone of the formation of contract in English law. For example, Aikens LJ in the *Barbudev* case (2012)[18] acknowledged that *Walford v Miles* is binding authority for the proposition that an agreement to agree is not binding. The *Barbudev* case[19] concerned a written arrangement intended to allow a party to become an active investment participant in a company. This was a complex set of arrangements and not a simple purchase of a specified percentage of shares at an agreed price. The court concluded that this was an irredeemably half-baked investment agreement, including a commitment to negotiate all further terms in good faith (the latter was condemned as void on the authority of *Walford v Miles*).

However, the English Court of Appeal in *MRI Trading AG v Erdenet Mining Corp LLC* (2013)[20] distinguished the situation where an agreement to agree concerns matters around the rim of the core agreement and the latter is already valid, effective, and operative.

By contrast, *BJ Aviation Ltd v Pool Aviation Ltd* (2002) demonstrates that an agreement to agree will be invalid if the relevant issue is a condition precedent to the proposed contract, requiring agreement to have been achieved by a specified date (in that case an agreement to negotiate the rent for a new lease); and, if the parties fail to agree, the fixed timetable leaves no opportunity to invoke external machinery to establish such a term by reference to objective criteria.[21]

**2.12** A qualification must also be noted in the context of tenders. The Privy Council in *Pratt Contractors Ltd v Transit New Zealand* (2003) acknowledged that there is *an implied duty on the part of the invitor to conduct the tender process in good faith* (**3.30**).[22]

**2.13** Nor does English law uphold an obligation to use best reasonable endeavours to reach agreement on the main part of the proposed deal, for example the nature of the subject matter or the price: 'an undertaking to use one's best endeavours to agree . . . is no different from an undertaking to agree, to try to agree, or to negotiate with a view to reaching an agreement; all are equally uncertain and incapable of giving rise to an enforceable obligation.'[23] Consistent with the English law approach, in *Hyundai Engineering & Construction Co Ltd v Vigour Ltd* (2005),[24] the Hong Kong Court of Appeal held that an agreement to use best endeavours to negotiate or to negotiate in good faith was not enforceable. This was because a court was not in a position to determine the good faith or otherwise of negotiations, as a party was entitled to negotiate in any way it felt fit.[25]

**2.14** However, a so-called 'lock-out' agreement is valid.[26] Here A and B agree for consideration (in other words, for a price or something in return) that A or B, or perhaps both, will not negotiate with third parties (nor solicit offers, etc). The



[15] For a Hong Kong case on implied contract, see *International Trading Co Ltd v Lai Kam Man and Others* [2004] 2 HKLRD 937.

[16] [1992] 2 AC 128, HL.

[17] [1992] 2 AC 128, 138, HL.



[18] [2013] EWCA Civ 156; [2013] 1 CLC 423; [2013] 1 Lloyd's Rep 638.

[19] [2002] EWCA Civ 163; [2002] 2 P & CR 25, at [27], [29], and [32], *per* Chadwick LJ.

[20] [2003] UKPC 83; [2004] BLR 143; 100 Con LR 29.

[21] *Little v Courage Ltd* (1994) 70 P & CR 469, 476, CA; *London & Regional Investments Ltd v TBI plc* [2002] EWCA Civ 355, at [39] and [40].

[22] [2005] 3 HKLRD 723; applied in *Hong Jing Co Ltd v Zhuhai Kwok Yuen Investment Co Ltd* [2012] HKEC 995.

[23] ibid, at 733E–G, applying *Walford v Miles* [1992] 1 AC 128; *WN Hillas & Co Ltd v Arcos Ltd* (1932) 43 LIL Rep 359; *Courtney & Fairbairn Ltd v Tolaini Brothers (Hotels) Ltd* [1975] 1 WLR 297.

parties to such a lock-out agreement must specify a fixed period.[27] It cannot be left to apply for a vague period, for example, 'for a reasonable period' or 'for as long as necessary or reasonable', otherwise the question of the reasonableness of one party's withdrawal from negotiations would arise in a different guise.[28] On this basis, a 'lock out' agreement for two weeks was upheld by the Court of Appeal in *Pitt v PHH Asset Management Ltd* (1994).[29] In *Walford v Miles* (1992) the House of Lords explained that objection to a chronologically vague or open-ended 'exclusivity' commitment is that the courts would need to address whether the lock-out or exclusivity agreement had been prematurely disapplied by a party. That would require the court to determine the 'impossible' issue whether a party had failed to negotiate reasonably or in good faith.[30]

**2.15** The *Walford* (1992)[31] and *Little v Courage* (1994)[32] cases acknowledge as settled law[33] the validity of an agreement to use 'best', 'all reasonable endeavours', or 'reasonable endeavours' to obtain planning permission, an export licence, or to procure a third party's consent. Such an obligation is not an absolute guarantee of success. It is an ancillary agreement designed to procure a specific external consent necessary for the achievement of the main transaction. The commitment to use 'reasonable or best endeavours' is precise and constitutes only a limited undertaking, in effect to 'try to unlock the door' with a third party. Its recognition does not fetter the parties' freedom to negotiate. Obligations to exercise '*best* endeavours' or '*all reasonable* endeavours' are more onerous than those to exercise '*reasonable* endeavours' (although 'all reasonable endeavours' might be similar to 'best endeavours').[34] In England, Vos J in the 'Chelsea Barracks case' (2010) held that an obligation to use '*all reasonable but commercially prudent endeavours*' in obtaining planning permission (a) does not require a party 'to ignore or forego its commercial interests', but (b) allows requires that party 'to take all reasonable steps to procure the Planning Permission, provided those steps are commercially prudent'; and he added (c) that an obligation to use 'all reasonable but commercially prudent endeavours' is 'not equivalent to a "best endeavours" obligation'.[35]

[27] Applied in *Pitt v PHH Asset Management Ltd* [1994] 1 WLR 327, CA.

[28] *Sharma v Simposh Ltd* [2011] EWCA Civ 1383; [2013] Ch 23 decides that even if an exclusivity agreement is legally invalid, a deposit made to secure such an undertaking will not be recoverable if the payee has honoured the terms of the (invalid) exclusivity agreement.

[29] [1994] 1 WLR 327, CA.

[30] *Walford v Miles* [1992] 2 AC 128, 140, HL.

[31] [1992] 2 AC 128, at 139–40, HL.

[32] (1994) 70 P & CR 469, 476, CA.

[33] Other authorities: *P&O Property Holdings Ltd v Norwich Union Life Insurance Society* (1994) 68 P & CR 261, HL; *Phillips Petroleum Co UK Ltd v Enron Europe Ltd* [1997] CLC 329, CA; *Rae Lambert v HTV Cymru (Wales) Ltd* [1998] FSR 874, CA; and see the cases cited in the next note.

[34] *Rhodia International Holdings Ltd v Huntsman International LLC* [2007] EWHC 292 (Comm); [2007] 2 Lloyd's Rep 325, at [33]ff (noted by B Holland (2007) 18 Int Comp & Comm L Rev 349); also examining *Yewbelle Ltd v London Green Developments Ltd* [2006] EWHC 3166 (Ch) (Lewison J) at



In *Okachi (Hong Kong) Co Ltd v Nominee (Holding) Ltd* (2007),[36] the Hong Kong Court of Appeal held that the phrase *using best endeavours* strengthens the obligations and means that the party so undertakes shall take *all reasonable steps* which a prudent and determined man acting in his own interests and anxious in completing the transaction would have taken, and that second best endeavours will not do.[37]

**2.16** *Criticism of the Walford Case:* However, the decision in the *Walford* case has been criticised.[38] Hoskins (2014)[39] contends that an agreement to negotiate in good faith might be legally binding if (a) the parties' agreement discloses an intent to create legal relations and (b)(i) either there are explicit criteria, of requisite certainty, regulating the agreement to negotiate, or (b)(ii) such criteria are implicit (that is, the agreement to negotiate, read in context, supplies such criteria). The courts are unlikely to find element (a) if there are no explicit criteria under (b)(i). The chances of implying criteria under (b)(ii) are slim if the main agreement has not arisen. But, as Hoskins explores at length, it will be much more likely that problems of certainty will be overcome where the negotiation agreement is ancillary to a main agreement which has already taken effect.

As for express agreements to negotiate in good faith, Berg (2009), writing in the *Law Quarterly Review* (2003), has suggested a radically new approach:[40] even where the main contract has not yet been formed, an agreement to negotiate in good faith should validly impose various implied negotiation duties. Berg proposes as follows:

> An undertaking to negotiate 'in good faith' is to be construed as an agreement to renounce purely adversarial negotiation. Subject to the particular factual setting, such an undertaking can be taken to involve: (1) an obligation to commence negotiations and to have some minimum participation in them; compare *Cable & Wireless plc v IBM United Kingdom Ltd* (2002),[41] where the contract required the parties to go through a clearly defined mediation procedure.

However, these criticisms are not convincing.

**2.17** *Post-formation or 'Ancillary' Negotiation Agreements:* As Longmore LJ has noted, in reasoned *dicta* in *Petromec Inc. v Petroleo Brasileiro SA* (2005)[42] *the*

[36] *Okachi (Hong Kong) Co Ltd v Nominee (Holding) Ltd*, Court of Appeal [2007] 1 HKLRD 55; [2006] HKEC 2132.

[37] Citing *IBM United Kingdom Ltd v Rockware Glass Ltd* [1942] 2 WWR 603.

[38] Lord Steyn, 'Contract Law' (1997) 113 LQR 433, 439; Lord Neill QC, 'A Key to Lock-Out Agreements' (1992) 108 LQR 404, 410; H Kötz, in P Cane and J Stapleton (eds) *The Law of Obligations: Essays in Celebration of John Fleming* (OUP, 1998) 244, 253n30, cites other literature on this case; H Hoskins (2014) 130 LQR 131–59.

[39] H Hoskins, 'Contractual Obligations to Negotiate in Good Faith: Faithfulness to the Agreed Common Purpose' (2014) 130 LQR 131.

[40] Berg, 'Promises to Negotiate in Good Faith' (2003) 119 LQR 357.

[41] [2002] EWHC 2059; [2002] 2 All ER (Comm) 1041.

*Walford* case (1992)[43] is confined to negotiations concerning the main contract (that is, where the main contract has yet to be crystallised following successful agreement). The position is different when the negotiation clause[44] is bolted onto a subsisting main agreement (no such main agreement had arisen in the *Walford* case) and the parties have provided an *objective and clear criterion* to determine whether the obligation has been breached. The following cases make clear the need for an objective criterion, but those cases also illustrate that the courts will approach that issue pragmatically and that the whole context must be considered in order to determine whether a reliable criterion has been identified.

The English Court of Appeal in *Didymi Corporation v Atlantic Lines* (1988)[45] upheld a hire variation clause designed to reflect the ship's speed and efficiency. Adjustment should be 'agreed' according to what was 'equitable'. The contract had already lasted for a significant period before the disputed issue arose. Another borderline case (discussed by Lord Neill QC observed in 1992)[46] is *Queensland Electricity Generating Board v New Hope Collieries* (1989).[47] Here, the Privy Council upheld a price variation clause. As Neill (in his journal article) explains:[48]

> The case concerned a 15-year supply contract whereby the Colliery Company agreed to supply coal to the Generating Board. For the first five-year period the contract contained a scale of base prices and elaborate "escalation" or "price variation" provisions for adjusting the base prices for changes in the company's costs. . . . The Generating Board contended (*inter alia*) that for the period after the first five years the agreement was uncertain and constituted nothing more than an agreement to agree. The Privy Council rejected this plea.

The English Court of Appeal in *Phillips Petroleum Co (UK) Ltd v Enron (Europe) Ltd* (1999)[49] approved (1) the *Didymi* case (1988) and (2) the *Queensland* case (1989) on the basis that both turned on objective set of criteria. But on the facts of the *Phillips* case, the Court of Appeal (Kennedy and Potter LJJ, Sir John Balcombe dissenting) held that the relevant negotiation clause lacked objective criteria and no criteria could be convincingly or reliably implied. This was a gas supply agreement. The English Court of Appeal (reversing Colman J) held that there was not enough certainty to support an obligation to use reasonable endeavours to agree

[43] [1992] 2 AC 128, at 139–40, HL.

[44] For a textbook suggestion that a court might imply a term to negotiate minor details if the main parts of a contract are established and those parts are intended to be binding, *Chitty on Contracts* (31st edn, Sweet & Maxwell, 2012) (32nd edn, due November 2015) 2-140 (citing *Donwin Productions Ltd v EMI Films Ltd*, 9 March 1984 (Peter Pain J); decision not followed in the context of incomplete compromise in *Dalgety Foods Holland BV v Deb-its Ltd* [1994] FSR 125, Nugee QC; and *Donwin* case not cited in *Walford v Miles* [1992] 2 AC 128, HL).

[45] [1988] 2 Lloyd's Rep 108, CA; noted by Reynolds (1988) 104 LQR 353.

[46] (1992) 108 LQR 405, 407–8.

[47] *Queensland Electricity Generating Board v New Hope Collieries* [1989] 1 Lloyd's Rep 205, PC (the court's judgment was given by Sir Robin Cooke; the other judges were Lords Diplock, Fraser, Roskill, and Brightman).

[48] ibid.



the date for supply of gas. Instead, this was an open-ended agreement to agree lacking reliable criteria. Colman J's decision to fetter this commercial bargaining discretion by prohibiting the purchaser from relying on its own commercial interests (the wholesale price had declined sharply) involved reading in a restriction for which there was no sensible commercial support.

3.18 *Mediation Agreements and Ancillary Negotiation Agreements:*[50] Finally, the law also upholds agreements to mediate disputes. Mediation agreements normally arise out of a pre-existing relationship, especially contractual relations. Mediation clauses (often part of a more complex multilevel dispute clause: see the next paragraph) are now a common feature of commercial contracts. As Colman J decided in *Cable & Wireless plc v IBM United Kingdom Ltd* (2002),[51] the courts will 'stay' (that is, place in suspense) formal proceedings until the stipulated prior mediation process has been properly considered. The innocent party can validly complain that the other party should not have bypassed the contractually obligatory mediation phase (although exceptionally this might be excused: see the case discussed below). It is of relevance that both the English procedural rules (the CPR) and the Hong Kong civil procedural rules (the RHC) emphasise generally the civil courts' responsibility to promote alternative dispute resolution.[52]

3.19 In *Cable & Wireless plc v IBM United Kingdom Ltd* (2002),[53] IBM had agreed to supply long-term IT services to Cable & Wireless. The contract contained a multilevel dispute resolution clause. It provided that, if a dispute arose concerning the adequacy of IBM's performance, the parties would first try to settle the matter in good faith among themselves. If the dispute remained unsettled, they agreed to take it to a higher level of management, again among themselves. If that did not work, they agreed to refer it to mediation before an external and named commercial mediator. If that failed, it was agreed that they would litigate. But Cable & Wireless skipped the mediation phase and went straight to the High Court. The substantive claim was for £45 million damages. Colman J upheld IBM's complaint that Cable & Wireless' commencement of High Court litigation was premature and a breach of the dispute resolution clause. Cable & Wireless should not have leap-frogged the mediation. To remedy this, Colman J ordered a 'stay' of the High Court proceedings. This was to enable the parties to pursue mediation. Only if that failed would the High Court case be reactivated, whereupon the stay would be lifted.

3.20 The English Court of Appeal in *Sulamerica Cia Nacional de Seguros SA v Enesa Engenharia SA* (2012)[54] established that a mediation agreement will be valid in English law only if (i) the mediation clause is final and thus does not require any further negotiation over its own terms; (ii) the clause nominates a mediation

[50] *Andrews on Civil Processes* (Intersentia, 2013) vol 2 (*Arbitration and Mediation*) 3.14ff; T Allen, *Mediation Law and Civil Practice* (Bloomsbury, 2013).

[51] *Cable & Wireless plc v IBM United Kingdom Ltd* [2002] 2 All ER (Comm) 1041.

[52] CPR 1998, Rule 1.4(2)(e).

[53] *Cable & Wireless plc v IBM United Kingdom Ltd* [2002] 2 All ER (Comm) 1041.

provider or indicates how one is to be appointed; and (iii) the mediation process should be either already finalised under the rules of the agreed mediation provider or the parties must themselves supply minimum details. (No problem of certainty will arise if the mediation clause refers to a well-established institutional 'model' set of mediation rules, as in *Cable & Wireless v IBM United Kingdom Ltd* (2002) [noted above], where the mediation clause incorporated an institutional set of mediation rules,[55] containing a detailed process.)[56] The mediation clause in the *Sulamerica* case (2012)[57] failed under all three of these heads. Clause 11 stated 'the parties undertake that, prior to a reference to arbitration, they will seek to have the Dispute resolved amicably by mediation.' The English Court of Appeal held that this was merely a 'gentlemen's agreement' that each party would invite the other to consider the possibility of an ad hoc mediation.[58]

**2.21** However, the English courts will not scrutinise the parties' conduct during a mediation hearing. Not only would such a judicial examination be difficult, but mediation discussions are also confidential and privileged. This means that no evidence can be adduced of what was said or written by the parties during the course of mediation discussions, unless both parties' permission is obtained to use such evidence. It is different if there has been a joint waiver of this evidential rule. And so Jack J in *Carleton v Strutt & Parker* (2008) said that the courts would consider the 'unreasonableness' of positions taken in the mediation if *the parties have waived privilege in their mediation communications*, and the question concerned assessment of costs in litigation subsequent to an unsuccessful mediation.[59]

**2.22** In *Emirates Trading Agency LLC v Prime Mineral Exports Private Ltd* (2014),[60] Teare J in the English Commercial Court upheld a negotiation clause (forming part of a wider dispute resolution clause), restricted to a fixed period of four weeks, requiring the parties to conduct 'friendly' negotiations as the mandatory prelude to commencing arbitration proceedings. He decided that the negotiation clause operates as a condition precedent to valid arbitral proceedings. But he held that, on the facts, there had been no failure to comply with this requirement. And so the relevant arbitration (held in London, commenced in June 2010, before a three-member panel, and under ICC rules) had been commenced validly.

**2.23** In Hong Kong, a contract to use best endeavours to mediate or to negotiate a settlement agreement was not enforceable.[61] As Hong Kong Court of Appeal in

[55] [2002] EWHC 2059 (Comm); [2002] 2 All ER (Comm) 1041; [2002] CLC 1319; [2003] BLR 89 at [21] *per* Colman J.

[56] ibid.

[57] [2012] EWCA Civ 638; [2013] 1 WLR 102; for criticism, N Andrews, 'Mediation Agreements: Time for a More Creative Approach by the English Courts' (2013) 18 Revue de droit uniforme (also known as Uniform Law Review) 6–16.

[58] [2012] EWCA Civ 638; [2013] 1 WLR 102 at [36], *per* Moore-Bick LJ.

[59] [2008] EWHC 424; 118 Con LR 68; [2008] 5 Costs LR 736; (2008) 105(15) LSG 24; (2008) 158 NLJ 480 at [72]; J Sorabji (2008) 27 *Civil Justice Quarterly* 288, 291–92.

[60] [2014] EWHC 2104 (Comm), notably at [59]–[64], distinguishing *Walford v Miles* [1992] 2 AC 128



*River Hong Kong Limited v Thakral Corporation (HK) Limited* (2008) observed, mediation as a means to settle disputes had increasingly been recognised in Hong Kong.[62] In *Supply Chain & Logistics Technology Limited v NEC Hong Kong Limited* (2009) Lam J discussed that failure to participate in mediation can be taken into account on the question of costs.[63] After the Hong Kong CJR came into effect, Lam J in *Golden Eagle International (Group) Limited v GR Investment Holdings Limited* (2010) though he left open whether the various considerations debated in *Halsey* should be applicable to Hong Kong—has decided that, on account of the defendant's unreasonable refusal to mediate, it should be liable to pay costs to the plaintiff on a common fund basis.[64] Lam J was of the view that, Hong Kong Practice Direction 31 supports the more robust approach of Lightman J (endorsed by Lord Phillips) instead of that adopted by Dyson LJ in *Halsey v Milton Keynes General NHS Trust*; and that the burden is on the part of the refusing party to provide a reasonable explanation.[65] The willing party does not carry any burden to show that mediation has a reasonable prospect of success.[66]

*Expert Determination Clauses:* Sometimes the parties might insert a clause requiring 'expert determination', for example the valuation of shares by a neutral third party auditor. The expert's decision is binding on the parties, but the process takes place outside the Arbitration Ordinance in Hong Kong or the Arbitration Act (1996) in the UK. Clark J in *Thames Valley Power Ltd v Total Gas & Power Ltd* (2005) held that the court might stay English court proceedings if they would involve a failure to adhere to an undertaking to refer the matter to 'expert determination'.[67] But on the facts of this case he exercised his discretion by deciding not to award a 'stay' because of the need for speed and also because he could see no substantive merit in the defaulting party's case.

*per* Reyes J at paras 113–15, applying the Hong Kong Court of Appeal decision in *Hyundai Engineering & Construction Co Ltd v Vigour Ltd* [2005] 3 HKLRD 723.

[2008] 4 HKLRD 1000, CACV 252 of 2007, 8 August 2008 (CA) in which the learned justices observed that those who have tried mediation usually find the process constructive even though not all mediations resulted in full settlement, using as an example the case of *Chun Wo Construction & Engineering Co Ltd v China Win Engineering Ltd* (unrep, HCCT 37/2006 [2008] HKEC 977); and cited a series of English authorities, including *Dunnett v Railtrack* [2002] 1 WLR 2423; *Halsey v Milton Keynes General Trust* [2004] 1 WLR 3002; *Burchell v Bullard* [2005] BLR 330; and *Egan v Motor Services (Bath) Ltd* [2007] EWCA Civ 1002.

*Supply Chain & Logistics Technology Limited v NEC Hong Kong Limited* [2009] HKEC 135, 2 January 2009 (Lam J)—a judgment on costs—Lam J at [11].

[2010] 3 HKLRD 273 at [46].

See Lam J's judgment on costs and interest in *Golden Eagle International (Group) Limited v GR Investment Holdings Limited* [2010] 3 HKLRD 273 at [44].

Also considered by Master Levy in *Ansar Mohammad v Global Legend Transportation Ltd* [2011]

Chapter 3

# Establishing Consensus

## *Offer and Acceptance*[1] *and Certainty*

CONTENTS



### (1) Introduction

**3.01** Formation of agreement is normally analysed in Hong Kong in terms of offer and acceptance. Thus, in many situations, especially when the parties are in correspondence, Hong Kong contract law requires an agreement to result from acceptance of an offer. However, some situations can produce a consensus without such a clear-cut form of dealing.

**3.02** An offer is a clear expression of an unequivocal willingness to be bound upon the offeree's acceptance (an acceptance is an unequivocal expression of willingness to accede, without significant qualification to the terms contained in the offer). The English Court of Appeal in *Crest Nicholson (Londinium) Limited v Akaria*

[1] J Cartwright, *Formation and Variation of Contracts: The Agreement, Formalities, Consideration and Promissory Estoppel* (Sweet & Maxwell, 2014); leading articles include: S Gardner, 'Trashing with



*Investments Ltd* (2010)[2] made clear that the supposed offeree (Y) must have objective and reasonable evidence that the other party (X) is making a sufficiently clear offer which expressly or impliedly invites acceptance. Y will fail if Y knows (and reasonably ought to have known) that X had become manifestly confused or mistaken, in ways inconsistent with the making of a true offer. Sir John Chadwick said:[3] 'the correct approach is to ask whether a person in the position of B (having the knowledge of the relevant circumstances which B had), acting reasonably, would understand that A was making a proposal to which he intended to be bound in the event of an unequivocal acceptance.' An offer can be made to an individual, a member of a group, or even the public at large. Acceptance presupposes knowledge of an offer. Acceptance must be made by an intended offeree: offers cannot be hijacked by strangers. The general rule is that contracts involving reciprocal obligations ('bilateral contracts') cannot be accepted *by silence*. But sometimes an agreement can arise if the offeree has acted on the offer in a manner indicating implied assent to it ('acceptance by conduct').

**3.03** Offers should be distinguished from mere 'invitations to treat'. Such an invitation is an opportunity for further dealings, but it is not a communication or presentation rendering the relevant party's goods or services open to immediate acceptance. For example, goods on display in shops are not available to be immediately accepted, and most advertisements for goods or services are regarded as 'invitations to treat'. But, even in the latter context, it is not impossible that the advertisement might be an open offer to readers to make an immediate acceptance, or to supply information producing entitlement to a reward, or at least to submit rival bids for 'sale at the highest suggested price'.

**3.04** An offeree can make a counter-offer (**3.20**). If this is rejected, and the original offer is not reinstated, the offeree cannot accept the original offer.[4]

**3.05** An offeree cannot validly accept an offer if the offeror has directly revoked it by communicating cancellation of the offer. Nor can the offeree validly accept if he has indirectly discovered that the offer is no longer open to acceptance by him. A statement that an offer is open to acceptance for a specified period has no effect. The offeror can freely revoke the offer, provided this revocation is communicated directly or indirectly to the offeree. It is different if there is a binding option made for consideration, or presented formally as a deed (on which see **4.05**), so that the offer is open to acceptance for a specified period.

**3.06** Hong Kong law adopts the 'postal rule' that fixes a valid agreement at the moment of posting, provided it is reasonable to send an acceptance by post, and provided

[2] [2010] EWCA Civ 1331, at [25] *per* Sir John Chadwick; also citing *Harvey v Facey* [1893] AC 552, PC; and see the statement of principles in *Schuldenfrei v Hilton (Inspector of Taxes)* [1999] STC 821; 72 TC 167; [1999] BTC 310; *Times*, 12 August 1999, CA, at [44], *per* Jonathan Parker LJ (amplified at [46], [48], and [49]) (approved by Mummery LJ in *Customs & Excise v DFS Furniture* [2002] EWCA Civ 1708; [2003] STC 1, at [42]).

[3] [2010] EWCA Civ 1331, at [25].

the offeror has not expressly required receipt of the acceptance. When the postal rule applies, acceptance is complete upon posting, even if the letter is delayed by the postal service (for reasons other than the offeree's fault), and even if the letter is lost in the post. However, it appears that the postal rule will not apply to contexts where it would involve 'manifest inconvenience' or 'absurdity'. This restriction might apply when a deadline for response has been specified, for example, a time limit has been prescribed for exercise of an option to buy property.

**3.07** Hong Kong law applies strictly the offer and acceptance analysis even if negotiations involve competing and discordant terms. The victor of a 'battle of forms' will be the person whose offer is eventually accepted by the opponent. In *Headwin Engineering Ltd v United Soundfair Engineering Co Ltd* (2008), it was found that the contract was formed as soon as the last set of forms was sent.[5]

**3.08** An 'invitor' requesting *tenders* does not normally commit himself to award the relevant contract to any person supplying a proposal. But he must at least consider valid tenders, disregard invalid tenders, refrain from making a final decision before a specified deadline has elapsed, and generally adhere to the specified terms of his tendering process. If there is no reserve price (or where the bid exceeds the reserve price), an *auctioneer* who refuses to 'knock down' a 'lot' in favour of the highest bidder is in breach of a collateral contract (on this type of contract, **6.23**), even though there is no contract of sale between the owner and the bidder. Finally, an offeror can commit himself to accept the highest or best bid, for example, by issuing invitations for *sealed bids* to purchase property. Each bid must normally be for a fixed and free-standing amount. The courts will not allow a 'referential bid' designed to top the other's fixed bid (unless, in addition to a fixed bid, a referential bid—subject to a cap—has been clearly invited under the terms of the invitation to bid).

**3.09** In the case of unilateral contracts (for example, 'I will pay you £1,000 if you find my cat, 'Gerald'), it is normal to regard the offeror as having 'waived the need for express acceptance'. The promisor becomes *fully* obliged to honour his commitment to pay £1,000, but only if the requested act has been fully performed in response to the offer. However, in some, but not all, situations, the offeror might lose his power to revoke the offer pending complete performance by the offeree, otherwise the offeree's reliance and expectations will not be protected. The better view is that such protection, where it is appropriate, is based on the implication of a *collateral* contract.

**3.10** The *objective principle* is a pervasive feature of Hong Kong contract law.[6] It requires the parties' language and conduct to be assessed according to their apparent and reasonable meaning and appearance (see further **3.33**).

**3.11** However, if party B knows that party A has made an apparent offer in error, or that A has presented the terms of the offer erroneously (for example, the price), party B

[5] [2008] HKEC 591.



cannot take advantage of A's error. Similarly, short of proof of *actual knowledge,* it *might be enough* that B ought reasonably to have realised that A has made such an error. However, where party B knows that A is mistaken concerning the *quality* of the relevant subject matter, or its unwarranted *value*, the law does not object to B taking advantage of A's error, even though this might be regarded as morally 'shabby'. But it is different if B knows that A believes that there is a tacit *warranty* that the subject matter should possess the relevant quality or value (this is the rule in *Smith v Hughes*, 1871, **6.58**, **6.59**); and it is *possibly* the law that A can then insist on enforcing the bargain on A's supposed terms.

## (2) 'Invitations to Treat' and 'Offers' Distinguished

**3.12** An offer is a clear expression of an unequivocal willingness to be bound upon the offeree's acceptance. An acceptance is an unequivocal expression of willingness to accede, without significant qualification, to the terms contained in the offer. Offers must be contrasted with preliminary communications not intended to be open to acceptance, namely 'invitations to treat'.

## (3) Invitations to Treat

**3.13** *Advertisements:* The *general* rule is that an advertisement of goods or services is *prima facie* an 'invitation to treat' and *not an offer*: *Grainger & Sons v Gough* (1896)[7] and *Partridge v Crittenden* (1968).[8] Therefore, advertising parties can decide whether to accept the responding public's requests for delivery. The rationale for this presumption is that advertising parties might otherwise be exposed to a torrent of demands.

However, UK and European Union consumer protection law prohibits misleading statements or omissions within advertisements.[9] And the European Court of Justice in the *Trento Svilippo srl* case (2013) made clear that it would a breach of European consumer protection law if a person responds to an advertised special deal by entering a shop but he is denied the relevant product on those advertised terms.[10] An Italian supermarket had been justifiably fined for such misleading advertising. Discounted laptops were not available to the consumer at the relevant shop during the specified discount period. It should be noted that this case is concerned with criminal sanctions for breach of European consumer protection. The case does not stand for the proposition that in English law an advertisement is other than an invitation to treat. As noted above, the general rule is that an advertisement concerning a product or service is not an offer.

[7] [1896] AC 325, HL.

[8] [1968] 1 WLR 1204, Div Ct.

[9] Consumer Protection from Unfair Trading Regulations 2008/1277, Part 2 prohibits misleading state-

**3.14** *Goods on Display:*[11] The rule is that goods displayed in a shop are not available for immediate acceptance. Such a display is regarded as a so-called 'invitation to treat'. This means that the customer's attempt to buy the goods is at best an offer. In stores where customers are allowed to roam the shelves, placing items in baskets or trolleys, and proceed to pay, it is the customer who makes an offer when she takes the goods to the cash desk. The proprietor and staff can refuse to accept that offer. In principle, the shop owner can refuse to sell even for quite capricious or odd reasons, for example, membership of the 'wrong' university, or support for the 'wrong' football team (but it would be legally unacceptable to do so on grounds of gender,[12] racial group,[13] or disability[14]). Indeed in some situations it will be an offence for the proprietor to sell certain controlled or prohibited substances: to persons under age wishing to purchase alcohol[15] or tobacco (and cigarettes),[16] and to adults wishing to buy firearms or ammunition.[17]

## (4) The Process of Offer and Acceptance in General

**3.15** A contract is normally formed by the exchange of an offer and acceptance and, usually, only between two parties. The House of Lords in *Gibson v Manchester CC* (1979) reaffirmed the need to apply the analysis of offer and acceptance in negotiations by sequential correspondence, notably discussions prior to the sale of land.[18] The House of Lords overturned Lord Denning MR (and one other judge's) majority decision in the Court of Appeal (where Lane LJ had dissented).[19] Lord Denning MR had said that offer and acceptance analysis was too rigid and out-of-date. The House of Lords held that the parties had yet to achieve a final agreement on the proposed purchase by a tenant of the freehold of a council house.[20] The defendant council decided to resile from these proposals when an incoming Labour administration decided to stop selling off its housing stock. The council had decided to resile even though the price had been fixed and the council had earlier assumed the deal would proceed. However, Lord Wilberforce in the Privy Council *New Zealand Shipping v Satterthwaite, 'The Eurymedon'* (1975) acknowledged that not all contractual situations are easily analysed in terms of offer and acceptance, for example, jumping on an (old-style) London

[11] *Fisher v Bell* [1961] 1 QB 394; cited in *HKSAR v Wan Hon Sik* [2001] 3 HKLRD 283; and, especially, *Pharmaceutical Soc of GB v Boots etc Ltd* [1953] 1 QB 401.

[12] Sections 5, 6, and 28, Sex Discrimination Ordinance (Cap 480).

[13] Sections 5 and 27, Race Discrimination Ordinance (Cap 602); cf *Timothy v Simpson* (1834) 6 C & P 499; 172 ER 1337; (1835) 1 CM & R 757; 149 ER 1285 (shopkeeper's anti-Semitic refusal to serve a Jew at listed price; attempt to raise ticketed price on spot; altercation; affray; arrest; allegation of false imprisonment).

[14] Disability Discrimination Ordinance (Cap 487).

[15] Reg 28, Dutiable Commodities (Liquor) Regulations (Cap 109B).

[16] Section 15A, Smoking (Public Health) Ordinance (Cap 371).

[17] Section 14, Firearms and Ammunition Ordinance (Cap 238).

[18] [1979] 1 WLR 294, HL; cited in *Calimpex International Co v ENZ Information Systems Ltd* [1994]



double-decker bus.[21] Similarly, Steyn LJ said in *Trentham (Percy) Ltd v Archital Luxfer* (1993):[22]

> offer and acceptance will in the vast majority of cases represent the mechanism of contract formation. It is so in the case of a contract alleged to have been made by an exchange of correspondence. But it is not necessarily so in the case of a contract alleged to have come into existence as a result of performance.

In other words, there will not always be a readily identifiable offer and acceptance. Instead, occasionally the courts must find consensus more flexibly.[23]

There are cooling-off periods applicable under European consumer protection, that, is statutory rights to cancel certain contracts: in 'distance and off-premises contracts between a trader and a consumer' for the supply of certain goods and services within the European Union, the consumer enjoys rights of cancellation within a fourteen day period.[24]

**3.16** *Acceptance and the Problem of Silence:* The general rule is that the offeree's silence does not constitute consent in bilateral contracts. *Felthouse v Bindley* (1861) is the decision normally cited in support of this[25] (although the case is problematic on its facts). Two policies support this general approach. First, it is necessary to protect offerees from having contracts thrust upon them by aggressive offerors, for example, 'unless you respond and say "no" within [a specified period], we will infer that you have consented to my terms'. The policy of protecting against such pressure-selling is confirmed in the case law.[26] The Hong Kong Court of Final Appeal found in *Flywin Co Ltd v Strong & Associates Ltd* (2002) that silence until four weeks before the completion date did not amount to acceptance of an encumbered title or a waiver of the right to object to encumbrance.[27] The second problem is that silence is equivocal: mistaken inferences can be drawn from a person's failure to respond, as the House of Lords acknowledged in *Vitol SA v Norelf Ltd ('The Santa Clara')* (1996).[28] But Lord Steyn admitted that, in some situations, silence might not be equivocal and that the context might indicate clear acceptance[29] (giving the example, in respect of the termination of a contract, of a

[19] [1975] AC 154, 167; cited in *City Polytechnic of Hong Kong v Blue Cross (Asia Pacific) Insurance Ltd* [1995] 2 HKLR 103; another problematic context where offer and acceptance proved elusive is *Clarke v Dunraven, 'The Satanita'* [1897] AC 59, HL.

[20] [1993] 1 Lloyd's Rep 25, CA; see Lord Clarke's summary of Steyn LJ's remarks in *RTS Flexible Systems Ltd v Molkerei Alois Müller GmbH* [2010] UKSC 14; [2010] 1 WLR 753, at [47], notably the statement: 'Contracts may come into existence, not as a result of offer and acceptance, but during and as a result of performance.'

[21] cf *Re Recher* [1972] Ch 526, Brightman J (unincorporated association; multi-party contractual matrix).

[22] Consumer Contracts (Information, Cancellation, and Additional Charges) Regulations 2013/3134, Part 3.

[23] (1862) 11 CB (NS) 869, 31 LJCP 204, 10 WR 423, Court of Common Pleas; affirmed (1863) 1 New Rep 401, 11 WR 429, 7 LT 835, Court of Exchequer Chamber; Miller (1972) 35 MLR 489; cf *Re Selectmove* [1995] 1 WLR 474, 478–79, CA.

[24] ibid.

[25] (2002) 5 HKCFAR 356; [2002] 2 HKLRD 485; [2002] HKCU 629.