2.1 INTRODUCTION

Before we examine the various stages of negotiating a contract and the significance of the terms that are agreed upon by the contracting parties, it is important to appreciate that a contract can be formed in the following ways:

- expressed — in the form of words
- implied — in the form of actions
- as a combination of words and actions.

Expressed Contracts

The term 'expressed contract' is used to describe a contract which is formed either by written or by spoken words. It was mentioned in the introduction to Part 2 that many people believe a contract must be formed in writing; in fact, very few contracts are required by the law to be formed in writing.

In practice, however, a written agreement is often preferred, because people believe that what is said may be forgotten. In addition, if a contract contains a number of terms, it may be impractical to rely on a spoken agreement. Therefore, most contracts formed in the course of a business will be in writing.

Contracts formed in writing may be of two types: formal and informal.

Formal Contracts

A formal contract may be in the form of either a deed or some other 'purpose-made' document which is signed by the parties to the contract.

In times past, a deed had to be 'signed, sealed, and delivered' and the seal was in the form of a mark made in red wax. Today, red paper is used, or a circle containing the letters 'LS' (*locus sigilli*), in the place of the seal.

Also the law no longer requires an individual (as distinct from a company) to seal a deed, as long as the words used in the document indicate that it is intended to be a deed (*Conveyancing and Property Ordinance*, s.19). However, a company is still bound to attach some form of seal to its deeds.

The signing of a deed usually requires witnessing by either one or two persons, who will then add their signatures to the deed following the statement, 'In the presence of ...', or 'Hereby witnesseth ...'.

Certain contracts are required to be in the form of a deed. A contract which is made by a deed is called a *specialty contract*. Whilst very few contracts are required to be written in the form of a deed, the *Conveyancing and Property Ordinance*, s.4, provides a notable example. A lease of property for a period of more than three years is required to be in the form of a deed.

In addition, a deed is required if a promise, such as a gift or an agreement which lacks consideration, is to be legally binding (see section 2.4 below).

Certain documents are also required to be in the form of a deed. For example, the *Conveyancing and Property Ordinance*, s.4, requires that a conveyance for the transfer of land is in the form of a deed. Also, if a person is to execute a deed under a power of attorney, the *Powers of Attorney Ordinance*, s.2, requires that his appointment must be by deed. A power of attorney is a form of agency and is a grant of power given by one person to another to create a deed on his behalf (see Chapter 10.2).

One of the advantages of creating a formal contract by deed is that an action for breach of the contract may be brought up to 12 years after the breach occurs. Otherwise, an action for breach of contract may be brought only up until six years after the breach occurs (*Limitation Ordinance*, s.4).

Contracts which are required to be in formal written form are also few in number. However, one important exception in terms of business law is a *bill of exchange*. Such bills, which include cheques and promissory notes, must by definition be in writing (*Bills of Exchange Ordinance*, s.3 — see Part 5).

Informal Contracts

An informal contract comprises letters or memoranda or other pieces of paper which together constitute 'evidence in writing' of a contract. Contracts which are required to be 'evidenced in writing' include agreements with money lenders, contracts of guarantee (see Chapter 8.2), and contracts for the sale of land. Unless there is sufficient written evidence, these contracts will not be enforced by the courts.

You should note that whilst s.4 of the *Conveyancing and Property Ordinance* requires a conveyance (transfer) of land to be in the form of a deed, a contract for the sale of land need only be 'evidenced in writing' (s.3(D)) or be sufficiently evidenced by acts of part performance (s.3(2)). The contract is the first stage in the process of buying land, whereas the conveyance is the final stage.

> In *Kwan Siu Ma v Yaacov Ozer* (1999) CFA, at a meeting by chance in the lift lobby of an apartment building, YO agreed to buy K's apartment for $4.25 million. Both parties believed that their respective lawyers would deal with all the necessary formalities. The trial judge and Court of Appeal regarded their agreement as an 'open contract' — the parties, the property and the price being the elements of such a contract, other matters being left to lawyers. The lower courts also held that a 'without prejudice' letter from K's solicitor to YO which mentioned, among other matters, the proposed sale and the amount to be paid as a deposit, was a sufficient memorandum of their contract.
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> The Court of Final Appeal held that an agreement which was lacking in the date for completing the conveyance, an essential term for a contract for the sale and purchase of land, was not an 'open contract'. The lawyers in this case would be doing more than simply dealing with the matters that are usually left to lawyers. The solicitor's letter was not a sufficient memorandum of the contract as finally agreed; their agreement did not constitute a contract and such a memorandum must evidence the contract and nothing else.

Generally it is the parties who decide whether they require a written contract. However, as mentioned earlier, most contracts made in the course of a business are usually in writing, in order to provide explicit evidence of what has been agreed. In

the event of a subsequent dispute, a written contract is obviously more reliable than spoken words.

> In *Professional Associates v Polytek Engineering Co Ltd* (1986), a number of company directors, including the directors of PEC, were contemplating a joint venture to build a hotel in China, and were involved in discussions with a partner of PA, a firm of architects, concerning the architectural services needed for the proposed hotel. Two months after the discussions, PA wrote to the companies saying that, in response to their request, it had commenced work on drawings and tender documents for the hotel. The letter also stated that their fees would be in accordance with the rules and regulations of the professional institute.
>
> The hotel project was abandoned and PA was instructed to take no further action. PA claimed payment for the services they had performed. The companies alleged that they had no contract with PA and were therefore not liable to pay any fees.

It was held that the parties had entered into an oral agreement under which PEC and the other companies were jointly liable for PA's fees. The work done by PA was authorised by PEC and the other companies and carried out according to their instructions.

Contracts Created by Electronic Means

Part III of the *Electronic Transactions Ordinance* (ss.5-9) provides that if the law permits or requires certain information to be 'in writing', an electronic record satisfies this requirement provided the record can be accessed for subsequent reference (s.5). Also that if a document is required to be signed, a *digital signature* satisfies the requirement if the person signing uses a reliable method to identify himself and the person to whom the signature is given approves of that method or if it is supported by a *digital certificate* (s.6). Many of the provisions in the Ordinance are concerned with ensuring that the electronic systems used are secure. A digital certificate is an electronic 'key' which is used to generate and verify digital signatures. Such keys must be issued by a certification authority: the Postmaster General is a certification authority.

5.1 INTRODUCTION

Many people have the impression that the law which governs contracts for the sale of goods applies only to contracts between businesspeople. This is not correct. The law which governs contracts for the sale of goods applies to both businesspeople trading in goods and individuals buying for private use/consumption.

Contracts for the sale of goods are an everyday occurrence: when you go shopping, your purchases of items such as food, clothing, or books are all contracts for the sale of goods.

Every contract for the sale of goods is governed by:

- the law of contract, and
- the *Sale of Goods Ordinance.*

The Law of Contract

We examined the law of contract in Part 2 of this book. All of those provisions apply to contracts for the sale of goods.

You will recall from Chapter 2 that an agreement will only be a legally binding contract and enforceable in the civil courts if it contains the essential elements of a contract, i.e. an offer, acceptance, and consideration. In addition, the parties must intend to create a legally binding contract and have the capacity to enter into the contract. An agreement relating to the sale of goods must fulfil these requirements in order to constitute a legally binding contract.

In *Nylex Plastics Ltd v Raneyko Enterprises* (1971), NP were manufacturers of plastic sandals and RE a firm engaged in import and export. They entered into an agreement concerning export to Somalia which provided that NP would sell sandals only to RE and RE agreed to take 12,000 pairs sandals within three months. Neither the price nor the styles was indicated in the agreement. RE argued that the agreement was a valid binding contract for the sale of goods. NP argued that it was 'an agreement to agree' and not legally binding.

It was held that the agreement was not a binding contract. It was a statement of willingness to trade upon certain terms. The parties did not intend to create a legal relationship when the agreement was signed, except that NP agreed only to sell to RE who agreed to place certain orders within a certain time.

The *Sale of Goods Ordinance*

A legally binding contract for the sale of goods is governed by the *Sale of Goods Ordinance* (the *SG Ordinance*). The provisions of that ordinance are the subject of this chapter, and throughout the chapter references to sections are to the *SG Ordinance*, unless stated otherwise.

The *SG Ordinance* is based upon the UK *Sale of Goods Act 1893* and was enacted in Hong Kong in 1896. The UK Act codified the law relating to the sale of goods. You will recall from Chapter 1 that a codifying statute is based upon the principles of law developed by the courts over the previous centuries. In the case of sale of goods, the development was by reference to the law merchant — that is, that part of the common law which developed from the customs and practices of traders selling and buying goods (see Chapter 1.2).

Since 1896 the *SG Ordinance* has been amended, in many cases following amendments in the United Kingdom, but in particular to include controls over exclusion clauses. Whilst we examined the general provisions governing all exemption clauses in Chapter 4, the provisions which apply specifically to contracts for the sale of goods will be examined later in this chapter. The provisions which govern exemption clauses in contracts for the sale of goods are now contained in the *Control of Exemption Clauses Ordinance.*

Before we proceed to consider the provisions of the *SG Ordinance*, we need to clarify exactly what the phrase 'contract for the sale of goods' means. It is essential that we can identify such contracts, because the *SG Ordinance* applies only to them. It does not apply, for example, to contracts for the sale of land or to contracts for laundry services.

The phrase 'contract for the sale of goods' can be divided into two key expressions:

- goods
- contract of sale.

Goods

The definition provided by the *SG Ordinance* describes goods as items of personal property (s.2(1)).

Personal property includes such things as clothes, jewellery, cars, furniture, electrical equipment and domestic animals. This type of property is distinguished from 'real property', which includes land, buildings, and things attached to buildings, such as lighting and air-conditioning systems. Crops grown on the land are personal property and fall within the definition of goods.

However, personal property in the form of things in action and money are excluded from the definition. 'Things in action' include bills of exchange, cheques, share certificates, debentures, and other such pieces of paper which entitle the holder to sue, i.e. to bring an action to the courts, if they are not honoured.

Goods must also be distinguished from services; a laundry is clearly a service, but in many cases a contract will involve both a service and the provision of goods. For example, a dentist who checks and maintains teeth provides a service, but he may also supply caps for teeth or medications.

If the main purpose of a contract is the skill and work involved in performing a service and the supply of goods is merely incidental, the contract is generally regarded as being for the services as opposed to the goods. Such contracts are not governed by the *SG Ordinance* but certain terms are implied by the *Supply of Services (Implied Terms) Ordinance*, and they are considered further in Chapter 6.

The question whether computer software is goods remained a matter for debate for many years but a distinction can be made between a disc, which is 'goods', and a

program which is 'instructions or commands telling the computer hardware what to do' which of itself is not goods. The courts have however said that although a program is not 'goods' such a contract would be subject to an implied term at common law that the programme would be reasonably fit for its intended purpose. A contract to write a new program is a contract for services. But a programme which is licenced for use, as opposed to being sold, does not fit any one of the categories.

Contract of Sale

A contract of sale is defined by way of two requirements:

- the terms of the contract must provide for transferring the ownership of the goods from the seller to the buyer, and
- the goods must be exchanged for money (s.3(1)).

The transfer of ownership is distinct from depositing goods as security. For example, if a watch is pledged with a pawnbroker, there is no transfer of ownership. The pawnbroker has possession of the watch, but the customer remains the owner. Contracts which involve using goods as security are not contracts of sale and are not governed by the *SG Ordinance* (s.62(4)).

The exchange of goods for money is distinct from contracts which involve an exchange of goods for goods. These contracts are described as contracts of barter and are not governed by the *SG Ordinance*. A contract of barter is a contract for the supply of goods, and such contracts are considered in Chapter 6. However, if goods are sold 'in part exchange' — that is, partly by exchanging goods and partly by money — the *SG Ordinance* will apply.

In addition, contracts for the hire-purchase of goods are not regarded as contracts for the sale of goods. Under a hire-purchase contract, goods are hired in return for the payment of instalments, and when the prescribed number of instalments has been paid there is an option to purchase the goods. Hire-purchase contracts will be explained in respect of being a contract for the supply of goods in Chapter 6, and together with other arrangements for buying goods on credit terms in Chapter 7.

Finally, with respect to defining the relevant terms, you should note that a contract for the sale of goods which is to be performed at some time in the future is described as *an agreement to sell* (s.3(3)). An agreement to sell becomes a contract of sale when the contract is performed (s.3(4)).

In relation to a contract for the sale of goods, the purpose of this chapter is to provide you with an understanding of:

- the effects of the express terms of the contract
- the terms implied into every contract
- the control of exemption clauses
- the transfer of ownership from the seller to the buyer
- the circumstances in which a buyer will become the owner of goods albeit the seller was not their owner
- the general duties of the buyer and of the seller
- the remedies available in the event of non-delivery, non-payment, and other breaches of the contract.

5.2 THE EXPRESS TERMS OF A CONTRACT FOR THE SALE OF GOODS

You will recall from Chapter 2.6 that at common law the express terms of a contract may be divided into conditions, warranties, and innominate terms. This division also applies to contracts for the sale of goods.

Conditions and Warranties

The *SG Ordinance* does not define what a condition is, it only prescribes its effect. It provides that if a condition is broken, the innocent party has a choice:

- he may treat the contract as repudiated (s.13(2)), and claim damages, or
- he may elect to treat the condition as a breach of warranty (s.13(1)).

You will recall from Chapter 4.2 that a contract which is lawfully repudiated is discharged.

The *SG Ordinance* defines a *warranty* as a term which is 'collateral' to the main purpose of the contract and provides that in the event of its being broken the innocent party is entitled to claim damages but not to reject the goods and treat the contract as repudiated (s.2(1)). A warranty is often described as a minor or subsidiary term of a contract.

A term which relates to the main or major purpose of the contract must therefore be a *condition*. However, whether an express term of a contract is a condition or warranty depends on the construction of the contract and not upon the words used in the contract. A provision which is described as a warranty may in fact be a condition, and vice versa (s.13(2)).

In practice, it is not easy to categorise terms into conditions and warranties. For example, Y agrees to buy a new car from X Motors and their agreement includes a 'condition' for servicing the car's engine, free of charge, when it has travelled 7,000 kilometres.

In this situation, the purchase of the car is the main purpose of the contract. If X Motors fail to supply the car, they will be in breach of that condition, and Y may elect to treat the contract as repudiated or he may treat the breach of condition as a breach of warranty.

The agreement to service the engine would probably be regarded as subsidiary, because it is collateral to the main purpose and therefore is a warranty. If X Motors fail to provide the service, despite the inclusion of the term 'condition', Y will only be entitled to claim damages. Y will not be entitled to reject the car and to treat the contract as repudiated.