HKU PRESS
香港大學出版社

Second Edition

Contract Law in Hong Kong

An Introductory Guide

Contract Law

Stephen D. Mau

Contents

Preface to the Second Edition viii
Preface to the First Edition ix
Acknowledgements x
Table of Cases xi
Table of Legislation xvi

1. Introduction 1
- A. Overview 1
- B. Organisation 2
- C. Definition 2

2. Classifications of Contract 5
- A. Oral and Written Contracts 5
- B. Contracts of Record and Simple Contracts 5
- C. Unilateral Contracts 6
- D. Collateral Contracts 6
- E. Third Party Contracts and Privity 7
- F. Formalities/Contracts Required to Be in Writing 8

3. Elements of a Contract 10
- A. Intent 10
- B. Agreement 11
  - i. Offer 12
    - 1. Bilateral and unilateral contracts 13
    - 2. Termination of offer 15
    - 3. Options 16
  - ii. Acceptance 16
    - 1. Postal Rule 16

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2. Counter-offer
3. Invitation to treat

C. Consideration
i. Adequacy and Sufficiency of Consideration
ii. Past Consideration
iii. Performing an Outstanding Obligation
iv. Equitable Estoppel
v. Accord and Satisfaction

4. Contents
A. Certainty of Terms
B. Contractual Provisions
i. Expressed and Implied Terms
ii. Conditions and Warranties
iii. Representations
iv. Puff
v. Factors of Classifications
vi. Effects of Classification
vii. Determining Classification
viii. Intermediate Term
C. Exclusion Clauses
D. Void for Uncertainty

5. Vitiating Factors
A. Capacity
B. Lack of Genuine Consent
i. Misrepresentation: Generally
1. Innocent misrepresentation
2. Fraudulent misrepresentation
3. Negligent misrepresentation
ii. Mistake: Generally
1. Unilateral mistake
2. Common mistake
3. Mutual mistake
4. *Non est factum*
iii. Duress
iv. Undue Influence
v. Unconscionable Bargain
vi. Illegal and Void Contracts

Discharge of Contract	79
A. Performance	79
i. Substantial Performance	80
ii. Severable Contracts	81
iii. Part Performance	82
iv. Induced Non-performance	82
B. Agreement, Assignment, and Novation	83
C. Repudiation and Anticipatory Breach	84
D. Frustration	86
E. Breach	87
Damages and Remedies	90
A. Damages	90
i. Principles of Damages	91
ii. Types of Damages	92
B. Liquidated Damages	93
C. Specific Performance	94
D. Restrictions on Remedies	95
Notes	99
References	135
Index	137

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4
Contents

This chapter is concerned with the contents or provisions o
Thus, this chapter will discuss the matters concerning the obli
responsibilities of the parties in the legally binding agreemen
its provisions.

A. Certainty of Terms

Before reviewing the provisions of an agreement, courts need t
whether the agreement is a legally enforceable contract. Recal
discussion concerning the elements of a legally binding agr
of these requirements for a contract is *certainty*. In other wor
requires sufficient details before the agreement can be enf
A contract cannot contain too many unknown features affe
such as quantity, price, place of delivery, time of delivery, paym
etc. This section discusses the need for certainty of terms in ord
legally enforceable agreement.

The parties to a contract undertake obligations and ot
rights as defined in the provisions of their contract. These pr
be expressed or implied. These provisions, however, must not b
uncertain or ambiguous that a court is unable to apply the
cannot apply or enforce the agreement's provisions, the cou
for uncertainty. The general rule is that the courts will interp
according to the parties' intentions at the time the contract wa

> The general rule is that, if the terms of an agreement are so
> or indefinite that it cannot be ascertained with reasonable ce
> what is the intention of the parties, there is no contract enf
> at law. This may happen in two ways: a clause may be devoid

> meaning or have such a wide variety of meanings that it is impossible to say which of them is intended. . . .
>
> The courts, however, do not expect commercial documents to be drafted with strict precision; the court will look at the document as a whole . . . in construing an agreement, a court should not hold a provision to be void for uncertainty unless it cannot resolve the ambiguity . . . Finally, it should be remembered that the degree of uncertainty in an agreement is a factor which may go to the question of whether or not the parties intend to create legal relations.[1]

The case of *Professional Associates v Polytek Engineering Co Ltd* [1986] HKLR 20 involved the issue of the existence of a contract between an architectural firm and several companies proposing a hotel construction project in the People's Republic of China. The joint venture company responsible for the actual construction project had yet to be created and the approval of Mainland officials had yet to be obtained. The Hong Kong High Court, in deciding the existence of a contract, discussed the element of certainty by referring to the case of *G Scammell and Nephew Ltd v H C and J G Ouston* [1941] AC 251. The Hong Kong High Court stated:

> that in order for a contract to be binding the terms must be so definite that no further agreement is necessary between the parties to render them certain . . . As a matter of law the contract price must be certain. But certainty may be achieved by more than one route. The common and simple alternative is for an express fixed contract sum to be stipulated. However, the contract price is equally certain if instead of an express fixed sum, a formula is agreed upon under which the contract price may be ascertained, without further agreement by the parties.[2]

B. Contractual Provisions

Once the certainty of terms is found to exist and assuming all the other elements are present, the next step is to examine these terms for their meaning or intent. This is because the provisions of a contract define the obligations and the rights of the parties to that contract.

> Assuming that a contract has been validly created, it is necessary to consider the extent of the obligations imposed on the parties by the contract. In order to do this, the exact terms of the contract must be determined and their comparative importance evaluated.[3]

Thus, as discussed in the preceding section, the provisions of a contract must be sufficiently certain or definite so as to be enforceable in court.

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In this section, we review how a court may interpret a
provisions.

The provisions of a contract are frequently disputed
claims a different interpretation of a particular provision
in the case of *Pacific Dunlop Garments Ltd v Fundamen*
[2014] HKEC 609, the dispute involved the interpretation
'unacceptable risks . . . to the Purchaser'. Specifically, the p
over whether this phrase should be determined subjectively
The Court of Appeal quoted the decision of the trial court ju

> Different people or companies must have different attitud
> taking. For a company, any risks taking decision must dep
> host of factors, e.g., financial ability, the return, the busi
> and the ethos of the management. I simply cannot see how
> ability of risks can be assessed with a notional reasonable co
> What are the attributes of this reasonable company? Is it
> to assume that the management is conservative or adventu
> somewhere in the middle, and what does it mean when the
> ment is neither conservative nor adventurous?[4]

The Court of Appeal continued:

> In my judgment, the reasoning of the judge . . . is plain
> Effect must be given to the clear wording of the provision
> is concerned with "unacceptable risks to . . . the Purchaser
> no basis to water down the subjective element by grafting
> an objective standard.[5]

In the case of *Fully Profit (Asia) Ltd v Secretary for*
16 HKCFAR 351, the Court of Final Appeal was asked t
word 'house' in relation to a government land restriction
than one house can be erected on each lot. Fully Profit wa
single 26-storey building straddling five adjacent lots. This
have shops and facilities on the two lower floors and residen
remaining twenty-four floors. The Court of Final Appeal s

> What emerges from these cases—and other authorities o
> tual interpretation—is the overall importance of context w
> struing contractual terms. The statements of principle in
> *Compensation Scheme* and in *Jumbo King* refer time and t
> the relevant background against which the relevant contr
> contractual terms must be viewed. It is in my view not p
> helpful in most cases to refer to the "ordinary and natural

> of words because, as very often experience tells us, there can be much debate over exactly what is the ordinary or natural meaning of words. The surer guide to interpretation is context. . . . Here, I would just add that in the area of statutory and constitutional interpretation, it is context that is key; context is the starting point (together with purpose) rather than looking at what may be the natural and ordinary meaning of words.[6]

If the interpretation of a particular provision is not in dispute, the category of the provision might determine the type and amount of recovery an injured party may receive or the consequences a party may face for failing to fulfil its legal obligations.

To explain the legal principles more clearly, we will use the following scenario: Alice, a very rich *tai tai*, enters a shop seeking a refrigerator for a new designer home on the Peak into which Alice will move in 30 days. In 40 days, Alice will host an open-house party to show off her new home to her rich and influential friends. After long discussions with a shop's sales consultant, Alice enters into a contract with the shop for the purchase of a black Sub-Zero® brand of refrigerator for Alice's new home. What was said during those discussions? Did the sales consultant make any statements (known as *representations*) which influenced Alice's decision to buy the Sub-Zero® refrigerator rather than a Samsung® refrigerator? Did any portions of the discussions between Alice and the sales consultant become part of the contract? What are the consequences if the shop:

- delivers a yellow and purple coloured model?
- delivers a black Samsung® refrigerator?
- delivers a black Sub-Zero® refrigerator that has a scratch on the side which will be hidden once the refrigerator is installed in the cabinetry?
- delivers the correct product later than agreed?

i. Expressed and Implied Terms

A contract's provisions may be placed into several categories. The contents of a contract may be placed in the category of expressed or implied term. An *express term* is an expressed promise which forms an integral part of the contract. Even such a simple concept can have difficulties on application:

> [W]here there is such a contractual document, it by no means follows that that document will contain all the terms agreed between the parties. Leaving aside the possibility of implied terms, there may be (1) express oral terms, for most contracts may be made wholly or partly by word of mouth; or (2) a collateral contract.

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> Where there is a contractual document, the question whe... agreement between the parties contains additional, or even... dictory, oral terms is one of fact, to be decided by extrinsic... Once all the express terms of a contract have been ascertain... meaning is a matter of construction.[7]

An *implied term* is a term which the parties intended... would have included expressly if they had thought about... inclusion at the time of contracting.[8]

> Custom and usage may be used by the court to add an implie... The rationale is that the parties did not express all of the terms... agreement but only those necessary for this particular case... on regular trade customs and practices to complete the re... of the terms. As the courts are reluctant to imply such te... person arguing in favour of the inclusion of such a term has... that the custom is well-established in that particular trade... or locality. The implied term must be consistent with any... term as it is within the parties' powers to expressly ex... customary term.[9]

In order for a Hong Kong court to imply term(s) into... term(s) should be:

- reasonable and equitable;
- necessary to give effect to the contract (known as busin...
- so obvious that it 'goes without saying';
- capable of clear expression; and
- consistent with, and not contradict, any express term o...

These guidelines have been followed recently by the Cour... the case of *Hua Ning Industries Ltd v Best Leader Engineer...* HKEC 228 and by the Court of First Instance in the case of... *v Wong Chung Kai* [2015] HKEC 1241.

Parties may insert a *merger clause* into the agreement... the courts that the written terms are the complete agreem... clause is intended to prevent one party from attempting to ... the contract with terms that were not originally included in...

ii. Conditions and Warranties

Previously, we stated that a contract's provisions may be pl... categories. The provisions in a contract may also be class...

category of *condition*[11] or under the category of *warranty*.[12] In the case of *The Moorcock* (1889) 14 PD 64, the court determined that the word *conditions* refers to the significant provisions of a contract. A *condition* is a term which goes to the basis or foundation of the contract, to the whole of the consideration. A *warranty* refers to a less important provision of a contract. A warranty is only part of the consideration.

> The predominant modern approach is to consider the nature of the terms of the contract in order to decide whether those terms are conditions or warranties. . . . a breach of condition entitles the innocent party to rescind the contract and claim damages for any loss he may have suffered, whereas a breach of warranty only entitles him to damages.[13]

Failure to act by an agreed date, or to meet a time requirement in a contract, is usually not a material or substantial breach of the contract. However, if the date fixed in the contract is expressly made *time is of the essence* by the parties, the failure to comply with this stipulation is a material breach. If the contract does not contain a deadline, the time for performance is whatever will be reasonable under the circumstances. An unreasonable delay in performance can be a material breach. In determining the reasonableness of the time of performance, the court will examine:

- the parties' intent;
- whether the parties have acted in good faith; and
- any hardship to the innocent party caused by the failure to fulfil the contract in time.

As will be further discussed later in this section, the present approach of the courts to evaluating contract provisions is to consider another category. This third category of contract provisions is known as an *intermediate* term or *innominate* term. *Innominate* means without a name.[14] A term is likely to be classified as *intermediate* if it is capable of being breached either:

- in a manner that is trivial and capable of remedy by a payment of damages, or
- in a manner that is so fundamental as to undermine the whole contract.[15]

This topic of intermediate term will be analysed in more detail in section viii. Depending upon the type and the consequences of a breach, the innocent party may or may not be discharged from the contract.[16]

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iii. Representations

A *representation* is the title given to a statement made to ... suade a party into making a contract.[17] Representations are ... contract and the legal consequences are different. According... ing the difference between a statement which is a condition ... is a representation becomes necessary.

> Basically, the problem is one of determining the inten... the parties as evidenced by their words and conduct, ... general principle of interpretation can be universally true, ... however, the intention of the parties seldom clearly appe... courts have had regard to any one or more of a number of ... for attributing an intention.[18]

iv. Puff

Puff refers to statements which neither party takes seriously ... considered to be the equivalent of the sales pitch made by a ... entice a customer to make a purchase.[19] Puff does not have ...

> A notable example in Hong Kong relates to estate agents' ... where it is generally accepted that descriptions should not ... literally. Attempts to sell new properties on the Pok Fu La... may feature photographs of apartments on the Mediterran... the justification that what is being indicated is a 'conce... behaviour is so widespread that it is fair to say that few Ho... people would take the images seriously. This view was give... support in *Chan Yeuk Yu & Another v Church Body of the ... Sheng Kung Hui & Another* where Burrell J, dealing with the ... 'regal surroundings for the select few' stated:
>
> > taken in its context, namely on page 4 of a 27-page ... glossy and colourful sales brochure, I find it difficult ... to conclude that it is any more than "mere puff" ... "sales pitch".[20]

v. Factors of Classifications

Whether a statement is a term (either a condition or a wa... sentation, or puff depends upon the parties' intentions. The ... important to determine what the parties intended a statem... guidelines are available to assist in classifying these statem...

- Time: If a statement was made at the beginning of ne... and not repeated, it is likely to be a representation. If it...

made repeatedly or emphasised near the conclusion of negotiations, it is likely to be a term.

- Importance: Occasionally, this criterion overlaps with the time guideline. If a statement is made at the beginning of negotiations and not mentioned again, it is likely to be a representation. However, if a statement sets the basis of negotiations, it may be a term. For example, if great stress was placed upon a particular aspect of the negotiations, that matter may become a term.[21]
- Expertise of parties: A statement made by a person with special knowledge is more likely to be a term.
- Writing: In a written contract, the document is presumed to contain all the terms; any omitted statements are presumed to be representations.

vi. Effects of Classification

A statement's classification is important when there is a breach of the contract. The classification determines the remedies available to the innocent party for any loss resulting from the breach:

- Breach of a contractual term may result in damages or specific performance.[22] A breach of condition results in the innocent party having the right to end the agreement as well as the right to sue for damages. Should the innocent party end the contract, the innocent party does not need to fulfil its own obligations under the agreement. Additionally, the innocent party may keep any benefit, as long as the agreement was ended and notice given of the termination within a reasonable time. In addition, the innocent party may sue for damages for the loss suffered. Alternatively, the innocent party may continue with the contract rather than end the agreement. In such a case, the innocent party may also sue for damages, treating the breach of condition as a breach of warranty. A breach of a warranty results in the innocent party having the right to claim damages; the innocent party has no right to terminate the contract.
- Misrepresentation may result in rescission under the common law or in damages under statutory law.
- Puff which is untrue does not allow recovery.

vii. Determining Classification

The general rule is that courts will interpret a contract according to the parties' intentions at the time the contract was made. 'The contract is to be construed so as to find and give effect to the intentions of the parties to it.'[23]

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Intention is to be found from the contract itself upon a pr
tion of its terms as a whole, according to the decision in Su
Société d'Armement Maritime SA v NV Rotterdamsche Kolen C
AC 361. As one authority has noted:

> The cardinal presumption is that the words of the agreem what the parties have in fact said, so that their words construed as they stand. . . . the meaning of the docum a particular part of it is to be sought *in the document itself* must consider the meaning of the words used, not what guess to be the intention of the parties". However, this is that the meaning of the words in a written document mus tained by reference to the words of the document alone. T will . . . look at all the circumstances surrounding the m contract . . . which would assist in determining how the langu the document would have been understood by a reasonable in their position.
>
> Further it has long been accepted that the courts approach the task of construction with too nice a concen upon individual words.[24]

Additionally, in matters concerning the interpretation note the *contra proferentem*[25] rule which states that courts any ambiguous contract provisions against the party wh agreement.

> *Contra* means against, and *proferentem* is a neat way of the person relying on the document – that is, the drafter *proferens*. Any ambiguities are construed against the pro is, the drafter never gets the benefit of any doubt.[26]

The purpose of a judicial interpretation of contract determine the importance which the contracting parties to these terms. This classification then assists in deter sequences of a breach of those contract provisions, beca breach determines the remedies available to the innocent

The seriousness of the results of a breach should ser mining factor in whether the breach was fundamental or breach is determined to be fundamental, the innocent its obligations under that contract as ended or discharg sue for damages. If the breach is considered to be minor may consider their obligations under that contract to be

performance is completed. A court, however, will still award damages upon proof of the breach.

viii. Intermediate Term

The case of *Hong Kong Fir Shipping Co v Kawasaki Kisen Kaisha* [1962] 2 QB 26 sets out the current approach towards using the intermediate (also known as *innominate*) term to interpret the provisions of a contract. Rather than automatically classifying the breach as one of condition or of warranty, the use of the innominate term seeks to be flexible. This approach recognises that the remedy for the breach will depend on the effect of the breach. This test considers all factors, including the circumstances of the breach, to determine whether a party has been deprived of the contract's benefits. If the answer is *yes*, the breach is treated as a breach of condition. If the answer is *no*, the breach is treated as a breach of warranty.[28] Thus, the result of the interpretation depends on the breach's consequences rather than following automatically from a prior classification as a condition or as a warranty.

In *Hong Kong Fir Shipping*, the defendants hired a ship for 24 months from February 1957 under an agreement which provided: 'She [the ship] being in every way fitted for ordinary cargo service.' The owners also agreed to maintain the ship 'in a thoroughly efficient state'. Upon delivery, the ship's engine room was undermanned and the staff incompetent. Upon the ship's arrival at one destination in May 1957, the defendants discovered that the ship required repairs which would take 15 weeks. The defendants wrote to the ship owners in June 1957 cancelling the agreement because of the owners' breaches of contract, claiming the failure to provide a seaworthy ship and the negligent failure to maintain the ship in a proper state. The ship became seaworthy in September 1957. The court determined that the breaches did not entitle the defendants to cancel the contract since neither the unseaworthiness nor the delay entitled them to do so. The unseaworthiness and failure to maintain were not breaches of conditions. Furthermore, the delay had not hindered the venture's commercial purpose.

One reason for this outcome is because courts hesitate to allow a party to cancel a contract in order to avoid a bad bargain. It appears that the defendants in *Hong Kong Fir Shipping* attempted to cancel the contract because freight rates had fallen since the commencement of the contract and the defendants could have hired other ships less expensively. However, the evidence showed that the defendants had not suffered any loss because,

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> **Obvious inference from agreement.** A term which has not been expressed may also be implied if it was so obviously a stipulation in the agreement that the parties must have intended it to form part of their contract. . . .
>
> A term will not, however, thus be implied unless the court is satisfied that *both* parties would, as reasonable men, have agreed to it had it been suggested to them. The knowledge or ignorance of each party of the matter to be implied, or of the facts on which the implication is based, is therefore a relevant factor.

If a court does not have some acceptable basis to uphold a court will not do so. Note for reference that some con implied by statute, e.g., the Sale of Goods Ordinance (Cap

5

Vitiating Factors

The ways in which an otherwise legally binding agreement may be set aside (*vitiated*, i.e., made void or voidable) are discussed in this chapter.[1] The grounds for vitiating a contract commonly focus on whether there was any genuine agreement, e.g., did a party actually know what it was doing, or did a party have any real choice? Thus, this generally concerns a party's ability to enter knowingly and voluntarily into a legally binding agreement, i.e., whether there was a 'meeting of the minds' of the parties. These grounds, which centre on the required elements of capacity and consent, will be discussed first. Other grounds to vitiate a contract will be presented at the end of this chapter.

A. Capacity

This refers to the legal ability, competency, or fitness of a party to knowingly enter and be bound by a contract. Here, *party* may refer to a natural person, i.e., an individual or a group of individuals. *Party* may also refer to a legal person, i.e., a legal entity such as a company. A party to a legally binding agreement must have the ability under the law to enter into a contract.[2] Without the ability to enter into a legally binding relationship, the party is considered to lack capacity. The general rule is that the law presumes every natural person has the capacity to make a contract unless falling within one of the following legal categories:

- a minor[3]
- a person who is intoxicated
- a person who is mentally disturbed[4]

A minor may enter into a contract. The other party to this agreement, however, takes a risk that the minor may not fulfil the contract where it is

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for non-essential goods or for money, i.e., the contract is
choice of the minor. In Hong Kong, an exception exists
of the District Court Ordinance (Cap 336).[5] This section
infancy (below 18 years old) is no defence to a debt les
However, where a contract concerns land, company sha
or is of a similar long-term or continuing nature, that co
at the minor's choice before reaching the age of 18 and
time afterwards.[6]

A person intoxicated at the time of making a contra
capacity to understand or appreciate the obligations of the
agreement. Thus, this person might not have the necess
willingness to enter into a contract. Being intoxicated do
cally make a person incapable of entering into contracts
ing intoxication at the time of contracting needs to prove

(a) Intoxication was to the level that prevented full ap nature of the contract and of the person's act in enteri at the time.
(b) The other party reasonably knew that the intoxi unable to act in a reasonable manner.

Similarly, to vitiate a contract on the grounds of a person of unsound mind, through his guardian or le must prove either that:

(a) this individual was too mentally incompetent to und and consequence of entering the contract at the tim
(b) the execution (e.g., signing) of the contract was a tion to a mental illness, and the other party had reas condition.

We now consider the capacity of a legal entity, m
company or business. Capacity, here, refers to the a
person, again particularly a company, to enter into co
capacity to contract is determined by its memorandum of
its articles of association. A company may, but is not re
objects (i.e., the company's objectives or reason for exis
trading company, service company, financial company
company, construction company, etc.) in its memorandu
If the objects are stated, the company's power is limit
If the company enters into a contract which is outside
and if the other party has actual knowledge of the co

contract would be invalid. The other party is not considered to know of a company's capacity to contract merely because the objects are stated in the memorandum and kept by the Registrar of Companies.[7]

B. Lack of Genuine Consent

We have discussed in the preceding section that to have a valid, legally binding agreement, the parties must have the ability to enter into the contract and be able to understand the contract's obligations. Another essential requirement for a valid contract is that the parties freely agreed to accept the terms and the obligations of that agreement. In short, the parties must be able to understand the contract provisions and be able to agree to the provisions. There might not be a valid, legally binding agreement where this consent is not genuine, i.e., is not freely and voluntarily given based on full and accurate knowledge of the contract's provisions. Presented below are common situations which might prevent a party from exercising its own free will in agreeing to the contract.

When reading this section concerning genuine consent, keep in mind the situation of *tai tai* Alice and the Sub-Zero® refrigerator for her new home on the Peak mentioned in Chapter 4, section B. What representations were made by whom to whom? What was said? Was any statement(s) relied upon in making a decision? Was the relied-upon statement(s) true?

i. Misrepresentation: Generally

Misrepresentation is where an innocent party is persuaded to enter into a contract by a factual statement, upon which that party relied, and the statement was untrue.[8] If the innocent party suffered loss or damage from its reliance on that statement, remedies might be available under several situations; these will be discussed later.[9] First, however, let us discuss the requirements of misrepresentation. These requirements can be found in the definition of *misrepresentation*: a false statement of fact which causes the recipient to enter into a contract with the person making the statement.

The first element that we will review is falsehood. The statement is false. The statement must not be correct or true. Although a statement was made both honestly and reasonably, this statement, if inaccurate, may still be a misrepresentation.[10]

Another element is a statement. This requirement of a statement may consist of written words, oral statements, or conduct. For example, in the case of *Spice Girls Ltd v Aprilia World Service BV* [2000] EMLR 478 the court found an implied representation that the girl group would stay together

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