[2-51] A plaintiff will not always, however, be able to rely on a non-conforming contract as a defence to a counter claim. In *Take Harvest Ltd v Liu*[64] a plaintiff sued for a refund of a tenancy deposit on grounds specified in an oral agreement. The defendant counterclaimed for rent under another contract which conformed to the requirements of section 3(1), and the plaintiff then submitted that its claim for a refund was in effect a defence to the counter-claim. The court rejected the plaintiff's contention:

> Their Lordships cannot accept in its unqualified form the proposition that, in cases such as this, an oral agreement is available as a defence in the same way and to the same extent as any enforceable contract. If due regard is to be paid to the statute, the question in any given case must be whether the party who relies on the oral agreement is in substance seeking to enforce it. If he is so seeking, it matters not whether he happens to be plaintiff or defendant in the proceedings or whether, as a matter of formal pleading, he is seeking to enforce the oral agreement by way of claim, defence, counterclaim or otherwise: compare *Delaney v TP Smith Ltd* [1946] KB 393, 399–401, per Wynn-Parry J. In any such case due effect must be given to the statute.

[2-52] Furthermore, severable promises falling outside the legislation's scope may remain actionable in contract notwithstanding a failure to comply with the legislative requirement of writing.[65] Whether a promise is severable from the main agreement is a question of construction in each case. A severable promise may be collateral to the main agreement in such a way that the main agreement is consideration for the collateral promise. Where this is the case, there will be a failure of consideration for the collateral promise if the main agreement is void. Where the main agreement is merely unenforceable, however, it can be effective to supply the collateral promise with consideration.

[2-53] Claims based on grounds other than contract, such as quantum meruit or restitution, may also remain open notwithstanding an agreement's non-compliance with the Statute of Frauds.[66]

10. Part Performance

[2-54] The requirement of writing in section 3(1) of the Conveyancing and Property Ordinance (Cap 219) is designed to prevent fraudulent claims. Yet it is quite possible that the provision's technical requirements might assist a party to avoid contractual obligations dishonestly. This was the experience in England, where the equivalent Statute of Frauds requirement was used by unscrupulous promisors to avoid obligations they had freely undertaken

64 *Take Harvest Ltd v Liu* [1993] AC 552, [1993] 2 All ER 459, [1994] 1 HKLR 32, [1992–1993] CPR 554 (PC, on appeal from Hong Kong).
65 *Mayfield v Wadsley* (1824) 3 Barnewall & Cresswell 357, 107 ER 766 (KB).
66 *Record v Bell* [1991] 4 All ER 471, [1991] 1 WLR 853 (Ch).

for value. A statute which was enacted to prevent fraud sometimes became, ironically, an aid to fraud.

[2-55] In order to address this species of injustice, the courts of equity soon began developing a doctrine which came to be known as 'part performance.' Indeed, only eight years after the Statute of Frauds was enacted, a court ordered specific performance of an unsigned agreement for the sale of land so as to avoid a fraud.[67] According to the doctrine, a court could order the equitable remedy of specific performance of a land contract that did not comply with the Statute of Fraud's requirements of writing where the party seeking relief had already partly performed the agreement. Once that party's part performance was established, parol evidence was admissible as to all of the contract's terms. The equitable doctrine's rationale rested on a version of estoppel; a party who has permitted another to perform acts in reliance on an agreement may not insist that the agreement is bad, or that he is entitled to treat those acts as if the agreement had never existed.[68]

[2-56] The doctrine of part performance no longer applies in England,[69] but has been expressly preserved in Hong Kong by section 3(2) of the Conveyancing and Property Ordinance (Cap 219).

10.1 Conduct constituting part performance

[2-57] Payment of the purchase price and entering into possession of the land are the 'clearest possible acts of part performance.'[70]

[2-58] It was long believed that payment of a deposit for the purchase or lease of land could not constitute part performance because payment of money was supposedly an equivocal act which did not necessarily indicate the existence of the very contract in issue.[71] In 1962, however, the English Court of Appeal in *Kingswood Estate Co Ltd v Anderson*[72] said that it was enough if the acts in question were necessarily referable to some contract concerning land, including possibly the alleged contract.

[2-59] In *Steadman v Steadman*[73] there had been an oral agreement between a husband and wife to settle the wife's claim for arrears of maintenance on the basis that the husband would pay £100 of the arrears and the wife would transfer

67 *Butcher v Stapely* (1685) 1 Vernon's Cases in Chancery 363, 23 ER 524 (Ch).
68 *Morphett v Jones* (1818) 1 Swanston 173, 36 ER 344.
69 Law of Property (Miscellaneous Provisions) Act 1989, s 2; *Godden v Merthyr Tydfil Housing Association* [1997] 1 NPC 1.
70 *Wu Koon Tai v Wu Yau Loi* [1996] 3 HKC 559, [1996] 2 HKLR 477 (PC, on appeal from Hong Kong).
71 Eg *Maddison v Alderson* (1883) 8 App Cas 467.
72 *Kingswood Estate Co Ltd v Anderson* [1963] 2 QB 169, [1962] 3 All ER 593 (CA, Eng).
73 *Steadman v Steadman* [1976] AC 536, [1974] 2 All ER 977 (HL).

her share of the matrimonial home to the husband for £1,500. This agreement was announced to the Magistrates' Court hearing the claim and the husband paid the £100. When he sent the draft deed of transfer to his wife, she refused to sign. The House of Lords held that although the transfer of money could not in itself be enough, it did prove part performance when considered together with all the other circumstances. The Board approved *Kingswood Estate*, and Lord Reid and Lord Dilhorne took a further step by favouring removal of the requirement that the acts must point unequivocally to the existence of some contract concerning land; it was enough if the acts were probably referable to some contract concerning land. According to Lord Reid:[74]

> I am aware that it has often been said that the acts relied on must necessarily or unequivocally indicate the existence of a contract. It may well be that we should consider whether any prudent reasonable man would have done those acts if there had not been a contract but many people are neither prudent nor reasonable and they might often spend money or prejudice their position not in reliance on a contract but in the optimistic expectation that a contract would follow. So if there were a rule that acts relied on as part performance must of their own nature unequivocally shew that there was a contract, it would be only in the rarest case that all other possible explanations could be excluded.
>
> In my view, unless the law is to be divorced from reason and principle, the rule must be that you take the whole circumstances, leaving aside evidence about the oral contract, and see whether it is proved that the acts relied on were done in reliance on a contract: that will be proved if it is shewn to be more probable than not.

[2-60] Lord Morris and Lord Salmon said that the acts must point unequivocally to some contract concerning land, and rejected the view that it was enough if they probably referred to such a contract. Lord Simon thought it unnecessary to choose between the two views. The judgment in *Steadman* has eroded the strict requirements of the Statute of Frauds. Nevertheless, not every act will constitute a sufficient expression of part performance. In *Take Harvest Ltd v Liu*[75] the Privy Council (on appeal from Hong Kong) appeared to approve of the views of Lord Reid and Lord Dilhorne in *Steadman*, and observed:[76]

> The decision of the House of Lords in *Steadman v Steadman* [1976] AC 536 shows that alleged acts of part performance have to be considered in their surrounding circumstances and must at the very least point, on the balance of probabilities, to the existence of a contract. The mere vacation by a tenant of the tenanted property cannot, by itself and without more, constitute an act of part performance because viewed in isolation it is equally consistent with the existence or non-existence of a contract to surrender the tenancy.

74 *Steadman v Steadman* [1976] AC 536 (HL) at 541–542.

75 *Take Harvest Ltd v Liu* [1993] AC 552, [1993] 2 All ER 459, [1994] 1 HKLR 32, [1992–1993] CPR 554 (PC, on appeal from Hong Kong).

76 *Take Harvest Ltd v Liu* [1993] AC 552 (PC, on appeal from Hong Kong) at 571. Cf *Re Gonin* [1979] Ch 16 at 30–31, [1977] 2 All ER 720, [1977] 3 WLR 379 (Ch), in which Walton J preferred the 'traditional equitable jurisprudence' of Lord Morris and Lord Salmon.

[2-61] A distinction must also be drawn between acts which are probably done in part performance of an oral agreement and other steps which are taken merely in anticipation of an agreement being reached. In *Shun Lin Weaving Factory Ltd v Siu Cheng Yee Wah Eva*,[77] Zimmern J held that instructions to solicitors to prepare a sale and purchase agreement could not constitute part performance as it did not indicate the probability of the alleged agreement, but was simply a step in preparation for reaching a concluded agreement.

[2-62] An even clearer illustration is provided by *World Food Fair Ltd v Hong Kong Island Development Ltd*.[78] The parties were negotiating a commercial lease of premises in the Palace Mall at Tsim Sha Tsui. The prospective tenant wished to operate a food court, and the landlords appeared receptive to the idea. Negotiations continued over many months during which it was verbally agreed, at least in principle, that the prospective tenant could lease a section of the premises and the landlords would provide certain kitchen facilities. The prospective tenant incurred numerous expenses in reliance on the in-principle agreement and paid an 'initial deposit' of $200,000. The landlords gave vacant possession, but they subsequently changed their mind about having a food court on the premises. No document in compliance with section 3(1) had yet been brought into existence, but the prospective tenant claimed damages for breach of contract on the basis that its conduct constituted sufficient part performance to defeat the formal obstacle. The Court of Final Appeal found that there was no contract on the inter-related grounds that essential terms had not been settled and that the parties had not exhibited an intention to create legal relations. In any event, the court held, the conduct of the prospective tenant had been ambiguous; it could not be said that the conduct was probably referable to an existing contract. In the words of Ribeiro PJ:

> 27. In my view, there is a circularity inherent in the Court of Appeal's approach. In regarding payment of the deposit and the giving of possession for fitting out works as "performance" which decisively proved the existence of a concluded contract, the Court of Appeal implicitly assumes that there existed a concluded contract of which such acts constituted "performance", which "performance" is then relied on to prove the existence of that very contract.
>
> 28. Such acts are no doubt consistent with the existence of a concluded contract but they do not prove its existence. They are no less consistent with being acts done in anticipation of a legally binding agreement which the parties confidently expected to enter into but which never materialised—which is what the Judge [at first instance] found was the position in the present case.
>
> 29. It is not uncommon for parties in the course of negotiations which are still incomplete or subject to contract to pay deposits or to allow builders access to the premises. Such acts are no doubt done with a view to commercial advantage but

77 *Shun Lin Weaving Factory Ltd v Siu Cheng Yee Wah Eva* [1980] 1 HKC 605 (HC).

78 *World Food Fair Ltd v Hong Kong Island Development Ltd* [2007] 1 HKC 387, (2006) 9 HKCFAR 735, [2007] 1 HKLRD 498 (CFA).

they involve the risk that the other party may decide to withdraw from the deal without any contract coming into being. [...]

32. A deposit paid pursuant to a concluded contract will generally be intended to secure performance of the contract and be subject to forfeiture (as discussed in *Polyset Ltd v Panhandat Ltd*[79]). But, as the authorities show, the parties may intend a different role for a deposit. If pre-contractual negotiations are lengthy, a deposit may be sought, not as an earnest of completion and performance, but as signifying serious intent on the part of the potential tenant or purchaser. Indeed, the request for an "initial deposit" rather than demanding execution of a tenancy agreement and the full deposit in the present case may suggest that the parties had not yet reached final agreement, since there would have been no need for the landlord to seek the comfort of an initial deposit if the parties were already legally bound.

10.2 Conduct by party denying existence of enforceable contract

[2-63] A notable feature of *Shun Lin Weaving Factory* is that the asserted act of part performance was carried out by the party denying the existence of an enforceable contract. The court did not rely on this as a ground for dismissing the claim notwithstanding that the doctrine has traditionally been confined to acts of part performance by the party seeking to enforce the agreement.[80]

[2-64] In the leading US case of *Schwedes v Romain*[81] the Supreme Court of Montana expressly held that neither the purchaser-plaintiffs' conduct in securing finance and offering to pay the full purchase price, nor the vendor-defendants' conduct in withholding the property from the market while the parties obtained a title report and in retaining an attorney to close the deal, constituted acts of part performance. The plaintiffs' acts were conduct performed 'in contemplation of eventual performance of the contract' and not, therefore, conduct in partial performance of an existing agreement. The defendants' conduct could not be relied upon by the plaintiffs 'because in order to remove the contract from the operation of the statute of frauds, a party may rely only on his part performance and not on the purported partial performance of others.'[82]

[2-65] This more confined idea of part performance is consistent with its usual conception as a species of estoppel, by which one party is prevented from permitting or acquiescing in the other party's partial performance of a contract and then denying its enforceability.

79 *Polyset Ltd v Panhandat Ltd* (2002) 5 HKCFAR 234 at 260–263, [2002] HKCU 145 (CFA).
80 Eg *Caton v Caton* (1865) LR 1 Ch App 137 (Ch) at 148, affirmed on appeal (1867) LR 2 HL 127 (HL); *New Lynn Borough v Auckland Bus Co Ltd* [1964] NZLR 511 at 516 (SC, NZ).
81 *Schwedes v Romain* 179 Mont 466, 587 P2d 388 (1978).
82 *Schwedes v Romain* 179 Mont 466 at 473.

10.3 Part performance and damages

[2-66] It has been held in Hong Kong that damages are not available for breach of a part-performed contract which is not in compliance with the Statute of Frauds, and that the only remedy is specific performance[83] if it is available.[84] Damages for breach of a part performed contract have since been made available by legislation.

Law Amendment and Reform (Consolidation) Ordinance (Cap 23)

13A. Part performance and damages

(1) A court may award damages for breach of a contract of which there has been part performance notwithstanding that an order for specific performance could not, in the circumstances of the case, be made by the court.

[2-67] The court's special power to award damages for breach of a part performed contract, even if specific performance is not available, supplements a more general power to award damages whenever specific performance is available in any cause of action:

High Court Ordinance (Cap 4)

17. Power to award damages as well as, or in substitution for, injunction or specific performance

Where the Court of Appeal or the Court of First Instance has jurisdiction to entertain an application for an injunction or specific performance, it may award damages in addition to, or in substitution for, an injunction or specific performance.

[2-68] The Hong Kong District Court possesses a materially identical power.[85]

83 *Chan Yat v Fung Keong Rubber Manufactory Ltd* [1967] HKLR 364 at 414 (SC).
84 As to specific performance and the restrictions on its availability, see para **[21-118]** et seq below.
85 District Court Ordinance (Cap 336), s 48A.

(c) The parties' unexpressed agreement may be revealed by a prior (or pre-contractual) course of dealings between them.
(d) The parties' unexpressed agreement may be revealed by post-contractual conduct that is unambiguously referable to an intention to comply with or rely on an obligation that was created at the time of the agreement's conclusion.
(e) Finally, even where the parties have not agreed an essential term, it may still be supplied as an implied term (in the correct sense of that expression) 'in law'.

[4-11] We shall deal in turn with each of the five techniques for identifying or implying essential terms.

3.1 Agreed mechanisms

[4-12] The parties may avoid uncertainty of essential terms by agreeing a mechanism by which the term can be determined. In *Hillas & Co Ltd v Arcos Ltd*, Lord Wright noted that in 'contracts for future performance over a period' the parties may be unable or unwilling to specify essential matters such as prices and delivery times in contracts for the sale of goods, or dates for loading and discharging in contracts of sea carriage; such contracts will be fatally uncertain unless the missing matters can be supplied 'as a matter of machinery' established by the parties.[10] In *May and Butcher Ltd v R*, Viscount Dunedin remarked that a contract 'may leave something which still has to be determined, but then that determination must be a determination which does not depend on the agreement between the parties', and 'a certain part of the contract … may be settled by somebody else'.[11]

3.1.1 Agreement to agree or negotiate

[4-13] The mechanism established by the parties can be anything that does not depend simply on their future agreement. By extension, an agreement to negotiate is void for uncertainty. In *Walford v Miles*,[12] the plaintiffs negotiated the purchase of the defendants' photographic processing business. The defendants sold to another party, but the plaintiffs alleged that the defendants had promised to continue negotiating only with them. The plaintiffs sued for breach of the alleged contract to continue negotiating. The House of Lords unanimously rejected the claim. According to Lord Ackner, 'the concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations'. As a result, negotiating parties are free to pursue their own interests and not reach an

10 *Hillas & Co Ltd v Arcos Ltd* [1932] All ER Rep 494 (HL) at 503–504.
11 *May and Butcher Ltd v R* [1934] 2 KB 17 at 22, [1929] All ER Rep 679 at 683-684 (HL).
12 *Walford v Miles* [1992] 2 AC 128, [1992] 1 All ER 453, [1992] 2 WLR 174 (CA, Eng).

agreement: 'The reason why an agreement to negotiate, like an agreement to agree, is unenforceable is simply because it lacks the necessary certainty.'[13]

3.1.2 Unilateral determination and good faith

[4-14] That there is no duty to negotiate in good faith is an instance of the wider proposition that there is no general duty of good faith in the common law of contract.[14] This is not to say, however, that there are no manifestations of an obligation of good faith in some specific aspects of contractual relations.[15] Indeed, it has been observed in Hong Kong that the common law, rather than importing any general concept of good faith, embraces 'a number of individual rules which provide remedies against specific forms of bad faith'.[16]

[4-15] As Viscount Dunedin recognised in *May and Butcher*, the task of supplying an essential term could be settled on a third party. The mechanism might also take the form of designating one of the parties to determine unilaterally the missing term without the need to obtain the other party's assent. It is easy to imagine how such an arrangement might be abused by the party in whom the discretion is conferred. Loan agreements providing for variable rates of interest are a common example. In all such cases, there exists a specific obligation of good faith on the party endowed with the discretion. Where the agreement allows one of the parties unilaterally to determine a term of the contract, that discretion must not be 'exercised dishonestly, for an improper purpose, capriciously or arbitrarily.'[17]

13 *Walford v Miles* [1992] 2 AC 128 at 138, [1992] 1 All ER 453 at 460 (CA, Eng); Lord Ackner accepted, however, the validity of a lock-out agreement according to which the parties agree that one or both of them will negotiate only with the other party for a certain period of time. Such an agreement does not lack certainty. The agreement in *Walford v Miles* was not a valid lock-out agreement because it did not specify the period of time for which the obligation was to last: [1992] 2 AC 128 at 139, [1992] 1 All ER 453 at 461-462, see also *Hong Jing Co Ltd v Zhuhai Kwok Yuen Investment Co Ltd* [2013] 1 HKLRD 441 at 460, [2012] HKCU 1463 (CA) (agreement not to negotiate with third parties for a period of 19 days).
14 Eg, *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] QB 433 at 439, [1988] 1 All ER 348 at 352-353, [1988] 2 WLR 615 (CA, Eng): 'English law has, characteristically, committed itself to no such overriding principle [of good faith] but has developed piecemeal solutions in response to demonstrated problems of unfairness' (Bingham LJ).
15 An obligation to perform in good faith can, for instance, be implied into certain contracts: see paras **[10-15]–[10-24]**.
16 *Kowloon Development Finance Ltd v Pendex Industries Ltd* (2013) 16 HKCFAR 336, [2013] 6 HKC 443 (CFA), para 20 (Lord Hoffmann NPJ).
17 *Paragon Finance plc v Nash* [2001] EWCA Civ 1466, [2002] 1 WLR 685 (CA, Eng) at 700. In *Chan Kam Yau v The Hong Kong University of Science & Technology* [2007] HKCU 2129 (unreported, DCCJ 4016/2002, 21 December 2007) (HKDC), the defendant University had exercised its unilateral discretion under a contract of employment to alter the terms on which two of its employees participated in a provident fund (all the other 166 employees in a similar situation having voluntarily agreed to new terms). The plaintiff employees argued that the new terms, under which their eventual pay out would depend on the fund's performance rather than the previously-prevailing fixed pre-determined formula, was an impermissible exercise of the University's unilateral contractual discretion. The District Court found for

3.1.3 Certainty of mechanism

[4-16] The mechanism agreed by the parties to resolve any uncertainty must itself be reasonably certain. A failure to specify a mechanism with reasonable certainty will cause it to fail.

Hyundai Engineering & Construction Co Ltd v Vigour Ltd

Court of Appeal
[2005] 1 HKC 579; [2005] 3 HKLRD 723

Vigour Ltd was carrying out certain development work for the Kowloon-Canton Railway Corporation ('KCR'). It contracted with Hyundai Engineering & Construction Co Ltd ('Hyundai') to construct hotel and office buildings as part of the project. The parties fell out. Hyundai claimed $900m from Vigour, and Vigour counter-claimed $200m from Hyundai. The contracts under which the work was done contained arbitration clauses, and Hyundai commenced arbitration proceedings. At a meeting of the parties, they signed an agreement purporting to terminate the arbitrations and settling their disputes. The agreement provided: *'The parties will not continue ...and will not bring any arbitration or court action ... and any right to sue each other will not be exercised any more mutually and the parties will start to discuss together to resolve any differences ... [and] anything that cannot be finalized will be resolved and decided by the managing directors ... provided failing an ultimate agreement then both parties shall agree and submit to Third Party Mediation procedure.'* Hyundai sought declarations to the effect, inter alia, that the agreement did not bar access to the courts and arbitration. It succeeded at first instance, and Vigour brought this appeal.

Rogers VP:

...

23. It is the aspect that the differences between the parties will be resolved and decided by those managing directors and in default submitted to Third Party Mediation that I consider causes difficulty. In essence I consider that it is no more than an agreement to agree.

24. The judge considered a number of authorities in this respect. Although he acknowledged the fact that apart from a statement by Lord Wright in *Hillas and Co Limited v Arcos Limited*,[18] which statement was criticised by Lord Denning in *Courtney & Fairbairn Limited v Tolaini Brothers (Hotels) Limited and another*,[19] the English authorities starting with the *Courtney* case and continuing through to the decision of the House of Lords in *Walford v Miles*[20] were consistent. As was said in that later case by Lord Ackner, with whom the other Lords agreed:[21]

the University. The court took the view that the new scheme was 'not without merits' and accepted that the high administration costs of maintaining the old scheme for only two employees was 'not worthwhile'. Consequently, the court was of the view that the University had not exercised its unilateral contractual discretion 'irrationally or perversely (of which caprice or capriousness [sic] would be a good example) in that no reasonable employer would have exercised his discretion in this way' (paras 41–43 of the judgment).

18 *Hillas & Co Ltd v Arcos Ltd* [1932] All ER Rep 494, (1932) 147 LT 503 at 515 (HL).

19 *Fairbairn Limited v Tolaini Brothers (Hotels) Limited and another* [1975] 1 All ER 716, [1975] 1 WLR 297 (CA, Eng).

20 *Walford v Miles* [1992] 2 AC 128, [1992] 1 All ER 453 (CA, Eng).

21 *Walford v Miles* [1992] 2 AC 128 at 138C, [1992] 1 All ER 453 (CA, Eng).

The reason why an agreement to negotiate, like an agreement to agree, is unenforceable, is simply because it lacks the necessary certainty.

25. In his speech Lord Ackner referred to the decision of the United States Court of Appeals, Third Circuit, in *Channel Home Centers, Division of Grace Retail Corporation v Grossman*.[22] That case had, apparently, been referred to the House of Lords on the basis that it was the 'clearest example' of the American cases showing that an enforceable agreement to negotiate does not offend against the general principles of contract law. Lord Ackner did not accept the approach of the United States Court of Appeals in so far as it equated an agreement to negotiate in good faith as being synonymous with an agreement to use best endeavours.

26. In considering the *Channel* case it is clear that the court there equated the use of best efforts with negotiating in good faith. That might have been relevant in that case because there was clear suspicion that the defendant had been acting in bad faith. The *Channel* case was somewhat unusual, to say the least. There had been negotiations between the plaintiff and the defendant who was in the course of purchasing a shopping mall. In order to assist the defendant to negotiate with bankers who might be financing the purchase, the plaintiff had signed a letter of intent to rent large parts of the shopping mall. The letter of intent was detailed and had, for example, specific rental provisions covering 25 years' rental. The defendant had countersigned the covering letter for that letter of intent which stated that to induce the plaintiff to proceed with the leasing of the store the defendant 'will withdraw the Store from the rental market, and only negotiate the above described leasing transaction to completion.' There was thus more than a simple undertaking to negotiate, there was an undertaking to withdraw the store from the rental market. It was the plaintiff's case that the defendant had been in gross breach of that provision. As a result the plaintiff applied for an interlocutory injunction. On the 10 minute hearing of the interlocutory injunction application, the injunction was not only refused but the action was struck out and hence the appeal to the Court of Appeals against the striking out. It is little surprise that their Lordships did not find the case of any great assistance.

27. ...When taken as a whole it is clear that what was being said [by Lord Ackner in *Walford v Miles*] was that a court is not in a position to determine the good faith or otherwise of negotiations because a party is entitled to negotiate in any way it feels fit. In the first place it is inevitably acting in its own best interests and in the second place the tactics of negotiation may vary from person to person. In some cases part of a negotiating tactic maybe to call off the negotiations hoping that better terms would be offered.

...

29. The next question turns on whether the words 'submit to Third Party Mediation procedure' add anything further. In my view they do not. Although, as was pointed out in the course of argument, mediation is likely to be a matter which is increasingly encouraged in Court procedure, the mediation referred to in the agreement does not have any precision to the extent of defining any specific steps which must be taken. This is in contrast to the situation that Colman J was dealing with in *Cable & Wireless plc v IBM UK Ltd*,[23] where there were specific details laid down for a formalised alternative dispute resolution procedure.

Le Pichon JA concurred. Yuen JA gave judgment agreeing with Rogers VP. Appeal dismissed.

22 *Channel Home Centers, Division of Grace Retail Corporation v Grossman* (1986) 795 F 2d 291.

23 *Cable & Wireless plc v IBM UK Ltd* [2002] EWHC 2059 (Comm), [2003] BLR 89 (QB).

[4-17] The most important flaw in the clause at issue in *Hyundai Engineering* was its failure to specify the steps to be taken in implementing the agreement to submit disputes to mediation. Who were to be the mediator or mediators? What procedures were they to follow? What would be the legal effect of any results of the mediation? The failure to settle these questions meant that the clause was merely an agreement to agree, and therefore fatally uncertain.

3.1.4 Arbitration

[4-18] It is not unusual for commercial contracts to contain a clause requiring the parties to submit unresolved disputes concerning the interpretation or application of contracts to arbitration.[24] In *May and Butcher*, both Lord Buckmaster and Viscount Dunedin recognised that the mechanism for supplying an uncertain term might take the form of arbitration. They were of the view, however, that the arbitration clause in the case before them was inapplicable because it operated in its own terms to resolve only 'disputes with reference to or arising out of this agreement': The House of Lords held that the parties' failure in *May and Butcher* to agree the price meant that there was no 'agreement', and therefore nothing to arbitrate.

[4-19] The preponderance of judicial opinion has, for a long time, been inhospitable to this aspect of the decision in *May and Butcher*. For instance some five years later in *Foley v Classique Coaches Ltd*,[25] the defendant coach operator had signed an agreement by which he committed to purchasing all his petrol requirements from the plaintiff 'at a price to be agreed by the parties in writing and from time to time' (the plaintiff had simultaneously sold the defendant some land on condition that it enter into the petrol agreement). There was also an arbitration clause which provided in part: 'If any dispute or difference shall arise on the subject matter or construction of this agreement the same shall be submitted to arbitration'. After the parties had been performing their obligations under the agreement for three years, the defendant rejected it on the basis that it was not binding because it did not specify a price for the petrol. The plaintiff succeeded in the English Court of Appeal, where Scrutton LJ accepted that *May and Butcher* 'had not lain down universal principles of construction' and that 'each case must be decided on the construction of the

24 The following is an example of an arbitration clause commonly found in Hong Kong commercial contracts: 'Any dispute, controversy, difference or claim arising out of or relating to this contract, including the existence, validity, interpretation, performance, breach or termination thereof or any dispute regarding non-contractual obligations arising out of or relating to it shall be referred to and finally resolved by arbitration administered by the Hong Kong International Arbitration Centre under the Hong Kong International Arbitration Centre Administered Arbitration rules in force when the Notice of Arbitration is submitted. The seat of arbitration shall be Hong Kong. The number of arbitrators shall be ['one' or 'three']. The arbitration proceedings shall be conducted in ['English' or 'Chinese'].'

25 *Foley v Classique Coaches Ltd* [1934] 2 KB 1, [1934] All ER Rep 88, 103 LJKB 550, 151 LT 242 (CA, Eng).

particular document'. Eliptically relying on section 8(1) of the Sale of Goods Act 1893 (UK), Scrutton LJ went on to say:[26]

> In the present case the parties obviously believed they had a contract and they acted for three years as if they had; they had an arbitration clause which relates to the subject-matter of the agreement as to the supply of petrol, and it seems to me that this arbitration clause applies to any failure to agree as to the price. By analogy to the case of a tied house there is to be implied in this contract a term that the petrol shall be supplied at a reasonable price and shall be of reasonable quality. For these reasons I think the Lord Chief Justice was right in holding that there was an effective and enforceable contract, although as to the future no definite price had been agreed with regard to the petrol.

[4-20] More recently, Blanchard J in the New Zealand Court of Appeal remarked in *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd*:[27]

> On its own facts we respectfully doubt that *May and Butcher* would be decided by Their Lordships in the same way today. We are now perhaps more accustomed to resort to arbitration in order to settle even matters of considerable importance to the contracting parties. We find curious the notion that, in a commercial contract where price is left to be agreed, a reasonable price cannot be fixed and that, even where there is an arbitration clause, that clause cannot be used to determine the price because 'unless the price has been fixed, the agreement is not there'.

[4-21] Provided an arbitration clause is in sufficiently wide terms, common law courts will nowadays readily permit the agreed arbitration mechanism to supply a missing term. As Sir Robin Cooke observed, while giving the advice of the Privy Council in *Queensland Electricity Generating Board v New Hope Collieries Pty Ltd*:[28]

> At the present day, in cases where the parties have agreed on an arbitration or valuation clause in wide enough terms, the Courts accord full weight to their manifest intention to create continuing legal relations. Arguments invoking alleged uncertainty, or alleged inadequacy in the machinery available to the Courts for making contractual rights effective, exert minimal attraction.

3.1.5 Non-cooperation with agreed mechanism

[4-22] If the machinery established by the parties is rendered ineffective because of the non-cooperation of one of the parties, a court will step in to fill the apparent gap in the essential terms if that machinery indicates an intention to settle the disagreement according to objective and justiciable criteria.

26 *Foley v Classique Coaches Ltd* [1934] 2 KB 1 at 10, [1934] All ER Rep 88 at 91 (CA, Eng).

27 *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd* [2002] 2 NZLR 433 (CA, NZ), para 61.

28 *Queensland Electricity Generating Board v New Hope Collieries Pty Ltd* [1989] 1 Lloyd's Rep 205 (PC) at 210.

[9-74] In *City and Westminster Properties (1934) Ltd v Mudd*,[114] landlords told a commercial tenant that if he would sign a lease they would not enforce against him a written term that he could not use the premises as a place to sleep. When the landlords brought proceedings for a breach of the covenant forbidding sleeping on the premises, the tenant was able to raise the contrary pre-contractual assurance as a collateral warranty and a good defence.[115] Similarly, in *J Evans & Son (Portsmouth) Ltd v Andrea Merzario Ltd*,[116] Lord Denning MR held that a collateral warranty given by the defendants that certain machinery would be shipped to England only below-decks overrode an inconsistent term in the written contract according to which the defendants had a discretion as to the manner of shipping the goods.

[9-75] The Court of Final Appeal has also accepted that a collateral warranty can override an inconsistent term in the main contract. In *Bank of China (Hong Kong) Ltd v Fung Chin Kan*,[117] the terms of a bank charge over the defendants' flat which specified that there was no upper limit to the amount it secured was unenforceable to the extent that it was inconsistent with a collateral warranty by the bank; the collateral warranty specified that the charge would secure loans up to a maximum of only $3.3m.

6.2.4 Diminished utility

[9-76] The utility of collateral warranty is not as great as it once was. It is significant that collateral warranty arose in the early twentieth century at a time when the 'four corners' rule of contract interpretation was still dominant. According to that rule, promises not reduced to the written record of an agreement could not be regarded as terms of the contract.[118] With the emergence of more contextual techniques of contract interpretation over the course of the twentieth century,[119] the need for collateral warranty was further diminished.

114 *City and Westminster Properties (1934) Ltd v Mudd* [1959] Ch 129, [1958] 2 All ER 733, [1958] 3 WLR 312 (Ch).

115 In Hong Kong, a collateral warranty will be unenforceable where it fails to conform with the requirements of writing prescribed by s 3 of the Conveyancing and Property Ordinance (Cap 219): *Cheuk Tze-Kwok v Leung Yin-King* [1992] 2 HKC 179, [1993] 2 HKLR 169 (CA). In *Wai Kam Chiu v Chim Siu Fan* [2008] HKCU 988 (unreported, CACV 376/2007, 24 June 2008) (CA), an oral collateral warranty contradicting the terms of a written tenancy agreement was enforced notwithstanding the former's non-compliance with s 3; *Cheuk Tze-Kwok* was distinguished on the basis that the collateral contract in that case had completely replaced the written agreement so that non-compliance with the legislative formalities was fatal.

116 *J Evans and Son (Portsmouth) Ltd v Andrea Merzario Ltd* [1976] 2 All ER 930, [1976] 1 WLR 1078, [1975] 1 Lloyd's Rep 162 (CA, Eng).

117 *Bank of China (Hong Kong) Ltd v Fung Chin Kan* (2002) 5 HKCFAR 515, [2003] 1 HKLRD 181, [2002] HKCU 1416 (CFA).

118 See para **[12-1]**.

119 See para **[12-4]** et seq.

[9-77] The large array of exceptions and qualifications to the parol evidence rule, moreover, now calls into question the desirability of relying on a highly contrived juridical device such as collateral contract if the more straightforward solution of a single composite agreement lies equally at hand.

[9-78] It was previously the rule that a collateral warranty would be unenforceable if it was inconsistent with a term of the main contract.[120] In *Andrea Merzario*, that rule was probably put to rest by Lord Denning MR. The other two members of the court (Roskill LJ and Geoffrey Lane LJ) also found for the plaintiff, but on the alternative ground that the main contract was a composite of written and oral terms; the defendant's assurance about below-decks shipment was incorporated into the main agreement and overrode the inconsistent written term. Similarly, in *Bank of China (Hong Kong) Ltd v Fung Chin Kan*,[121] a majority of the Court of Final Appeal decided that the defendant could succeed on the twin bases of collateral warranty and a composite oral/written agreement; in either case, the oral term overrode or negated the inconsistent written term as a matter of the parties' objectively ascertained contractual intentions.

[9-79] In any event, it remains the case in Hong Kong that collateral warranties adding to or varying the terms of a written contract must be strictly proved.[122]

6.2.5 Continuing resilience

[9-80] Notwithstanding its substantially diminished utility, collateral contract enjoys a continuing resilience even at a time when there would appear to be much less need for this rather artificial juridical device.

Bank of China (Hong Kong) Ltd v Fung Chin Kan

Court of Final Appeal
(2002) 5 HKCFAR 515; [2003] 1 HKLRD 181; [2002] HKCU 1416

Fung and his wife owned a flat in Mid-Levels. In May 1997, they executed a document titled 'Legal Charge' by which they mortgaged the flat to the bank as security for credit facilities provided by the bank to a company called System Management Consultancy Ltd ('SMC'). The Legal Charge operated, *prima facie*, as an unlimited guarantee for any debts which SMC might incur towards the bank. Fung and his wife executed the legal charge, but before doing so the bank (through its solicitor) told them that it would secure SMC's indebtedness up to a maximum of only $3.3m (the bank's solicitor had mistakenly drafted the legal charge in such

120 Eg *Hoyts Pty Ltd v Spencer* (1927) 27 CLR 133 (HC, Aust) at 139, per Knox CJ.

121 *Bank of China (Hong Kong) Ltd v Fung Chin Kan* (2002) 5 HKCFAR 515, [2003] 1 HKLRD 181; [2002] HKCU 1416 (CFA).

122 *Bank of India v Surtani Murlidhar Parmanand (t/a Ajantha Trading Corp)* [1994] 1 HKC 7 (CA) at 11–12; *Wai Kam Chiu v Chim Siu Fan* [2008] HKCU 988 (unreported, CACV 376/2007, 24 June 2008) para 23 (CA).

said in *Investors Compensation Scheme Ltd v West Bromwich Building Society*[128] concerning the interpretation of commercial documents: That all the old intellectual baggage of 'legal' interpretation has been discarded for the more modern approach, where the courts seek the true meaning of contracts by resort not only to the words used but also through the matrix of facts giving rise to the transaction. However, counsel never submitted at any time that the terms of the legal charge were ambiguous and that the words in cl 1(a) which fixed the respondents with liability — '*all* present and future indebtedness of the Principal' — were to be qualified in some way by reference to the matrix of facts: This is surprising, perhaps, since Lord Hoffmann's proposition in *Investors Compensation Scheme v West Bromwich* as referred to above (with which Lord Goff of Chieveley, Lord Hope of Craighead and Lord Clyde agreed) goes a long way to loosening the shackles of words found in commercial instruments: Whilst, as Lord Hoffmann said,[129] one does not easily accept that people have made linguistic mistakes, particularly in formal documents, nevertheless if one concludes 'from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had'. Here, the intention of *all* the parties plainly was that the respondents as chargors should be answerable for SMC's default up to $3.3m for which their flat was security ... Whilst, of course, in construing a written instrument, intention is objectively viewed, nevertheless when the party to whom such intention might be attributed never himself advanced such a case, it would transcend the frontiers of judicial boldness for the court to attempt to do so. In my judgment the approach as adopted earlier, by applying the principles of law concerning collateral contracts and by analogy with the case of *Walker Property Investment v Walker*, puts the case on a much sounder legal footing.

...

Mortimer NPJ:

66. I would allow this appeal for the reasons given by Mr Justice Litton NPJ. ...

...

68. It is useful ... to recognize that the dealings between Mr and Mrs Fung and the bank also bear sound legal analysis as a single composite agreement as set out in the judgment of Lord Cooke of Thorndon NPJ. In either event the legal charge on the chargors is limited to $3.3m.

Lord Cooke of Thorndon NPJ:

69. I agree with the judgment of Mr Justice Litton NPJ. He disposes of the case by applying the principles concerning collateral contracts, attaching particular importance to the bank's instructions to the solicitors, which were relayed, with implied authority from the bank, to the chargors. That analysis is open. Collateral contracts are certainly a familiar concept, as I have been acutely aware since Lord Denning's Privy Council judgment in *Mouat v Betts Motors Ltd*[130] described by a learned commentator as '... the most extreme modern case in which what looks like one bargain has been divided into two ...' KW Wedderburn (now Lord Wedderburn of Charlton) 'Collateral Contracts' [1959] CLJ 58, 74.

128 *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 All ER 98 at 114G, [1998] 1 WLR 896 at 912F to 913E (HL).

129 *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 All ER 98 at 115C, [1998] 1 WLR 896 at 913D (HL).

130 *Mouat v Betts Motors Ltd* [1959] AC 71 at 81, [1958] 3 All ER 402 at 405 (PC, on appeal from New Zealand).

70. An alternative analysis, leading to the same result, is that there was a single composite agreement, of which the legal charge was one component and the instructions another, imposing liability on the chargors in the terms detailed in the charge but limiting it to $ 3.3m specified in the instructions. Perhaps this approach is a more straightforward reflection of the true bargain between the bank and the chargors. This, too, is an application of a familiar concept and is not excluded by the parol evidence rule.

71. In my view both approaches are valid. It does not matter in this case which is to be preferred. An interesting parallel is *J Evans and Son (Portsmouth) Ltd v Andrea Merzario Ltd.*[131] There a condition previously agreed orally was held to limit widely-expressed printed conditions relating to the shipment of goods. Lord Denning MR analysed the case as one of a collateral contract, whereas Roskill and Geoffrey Lane LJ J saw it as one of a single contract of carriage on terms to be collected and reconciled from the dealings of the parties as a whole.

[9-81] Litton NPJ was alone in the view that the extrinsic assurance as to the upper limit of the legal charge could possess contractual force only as a collateral warranty. The other four members of the Court thought that the same result could be achieved simultaneously on the basis of a composite agreement combining the terms of the charge document itself with extrinsic material. In this respect, the majority's view was that the parol evidence rule did not preclude incorporation of the bank's upper-limit assurance into the main contract. Bokhary PJ and, to a lesser extent, Lord Cooke of Thorndon NPJ, expressed skepticism as to the necessity of invoking collateral warranty in circumstances where a less circuitous solution based on composite agreement lay to hand.

6.2.6 Tripartite arrangements

[9-82] The solution of a composite agreement or a variation agreement cannot, however, substitute in the case of a tripartite collateral contract. All the examples of collateral contract given above are bilateral in nature, ie X makes a promise to Y in exchange for Y entering into a contract with X. In a tripartite collateral contract, X makes a promise to Y in exchange for Y entering into a contract with Z. Because of problems with the doctrines of privity and consideration, X's pre-contractual promise cannot be incorporated into a composite agreement between Y and Z. This means that X's promise can be enforced by Y *only* as a collateral warranty supported by the consideration of a concluded contract between Y and Z.

[9-83] A typical scenario for a tripartite collateral contract is where a manufacturer makes a promise about his product on the basis that the promisee will purchase, or require someone else to purchase, the product from a third

131 *J Evans and Son (Portsmouth) Ltd v Andrea Merzario Ltd* [1976] 2 All ER 930, [1976] 1 WLR 1078 (CA, Eng).

been more suitable. An unexpressed term can be implied if and only if the court finds that the parties must have intended that term to form part of their contract …

[10-4] The modern common law principles controlling the implication of contract terms may be traced back to two cases in the 1970s, decided about fourteen months apart. In 1976, the House of Lords decided in *Liverpool City Council v Irwin*[2] that there are three varieties or types of implied terms. The following year, the Privy Council in *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings*[3] identified certain requirements that must be met in order to imply a contractual term.

2. Varieties of Implied Terms

[10-5] According to the House of Lords in *Liverpool City Council v Irwin*, there are three varieties or types of implied terms:[4]

(i) a term necessary to make the contract work may be implied even though there appears to be a complete bargain (or, terms implied 'in fact'),

(ii) where the parties have not fully stated the terms, a term may be implied 'to establish what the contract is' (or, terms implied 'in law'), and

(iii) 'established usage' (or, usage and (local) custom) which may be added to contracts even where the contract appears to be complete on its face.

2.1 *Necessity, implication 'in fact'*

[10-6] The first variety of implied terms consists of terms necessary to make the contract work and that may be implied even though there appears to be a complete bargain. This variety has been recently characterised as, 'a term which is implied into a particular contract in the light of the express terms, commercial common sense, and the facts known to both parties at the time the contract was made'.[5] The first variety is sometimes referred to as terms implied 'in fact' (ie, by reference to the particular facts of the contract).

2 *Liverpool City Council v Irwin* [1977] AC 239, [1976] 2 All ER 39, [1976] 2 WLR 562 (HL).

3 *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings* (1977) 180 CLR 266, (1977) 16 ALR 363, (1977) 52 ALJR 20.

4 *Liverpool City Council v Irwin* [1977] AC 239, 253-254, [1976] 2 All ER 39, 43, [1976] 2 WLR 562, 566-567 (HL) (Lord Wilberforce).

5 *Marks and Spencer plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd* [2015] UKSC 72, [2016] AC 742, [2016] 4 All ER 441, [2015] 3 WLR 1843, 163 Con LR 1, [2016] EGLR 8 (SC, Eng), para 15 (Lord Neuberger, Lord Sumption and Lord Hodge agreeing).

2.1.1 Business efficacy

[10-7] Terms implied 'in fact' are often justified as being necessary in order to give business efficacy to a contract.

The Moorcock

Court of Appeal (England and Wales)
(1889) LR 14 PD 64; [1886–90] All ER Rep 530; 5 TLR 316; 60 LT 654

The defendants operated a wharf in the River Thames, and the plaintiff owned a steamship known as *The Moorcock*. The parties agreed that the defendant would unload and load cargo aboard the vessel, and that the defendant's wharf should be used for the purpose. It was agreed that before the stevedoring work could commence, it would be necessary for the vessel to be tied to the wharf and for the tide to go out so that the vessel would be resting on the river bed. When the vessel came to rest on the river bed, its hull was damaged by a ridge of hard ground beneath the mud. The plaintiff sued in contract for damage to the vessel.

Bowen LJ:

The question which arises here is whether when a contract is made to let the use of this jetty to a ship which can only use it, as is known by both parties, by taking the ground, there is any implied warranty on the part of the owners of the jetty, and if so, what is the extent of the warranty. Now, an implied warranty, or, as it is called, a covenant in law, as distinguished from an express contract or express warranty, really is in all cases founded on the presumed intention of the parties, and upon reason. The implication which the law draws from what must obviously have been the intention of the parties, the law draws with the object of giving efficacy to the transaction and preventing such a failure of consideration as cannot have been within the contemplation of either side; and I believe if one were to take all the cases, and they are many, of implied warranties or covenants in law, it will be found that in all of them the law is raising an implication from the presumed intention of the parties with the object of giving to the transaction such efficacy as both parties must have intended that at all events it should have. In business transactions such as this, what the law desires to effect by the implication is to give such business efficacy to the transaction as must have been intended at all events by both parties who are business men; not to impose on one side all the perils of the transaction, or to emancipate one side from all the chances of failure, but to make each party promise in law as much, at all events, as it must have been in the contemplation of both parties that he should be responsible for in respect of those perils or chances.

Now what did each party in a case like this know? For if we are examining into their presumed intention we must examine into their minds as to what the transaction was. Both parties knew that this jetty was let out for hire, and knew that it could only be used under the contract by the ship taking the ground. They must have known that it was by grounding that she used the jetty; in fact, except so far as the transport to the jetty of the cargo in the ship was concerned, they must have known, both of them, that unless the ground was safe the ship would be simply buying an opportunity of danger, and that all consideration would fail unless some care had been taken to see that the ground was safe. In fact the business of the jetty could not be carried on except upon such a basis. The parties also knew that with regard to the safety of the ground outside the jetty the shipowner could know nothing at all, and the jetty owner might with reasonable care know everything. The owners of the jetty, or their servants, were there at high and low tide, and with little trouble they

could satisfy themselves, in case of doubt, as to whether the berth was reasonably safe. The ship's owner, on the other hand, had not the means of verifying the state of the jetty, because the berth itself opposite the jetty might be occupied by another ship at any moment.

Now the question is how much of the peril of the safety of this berth is it necessary to assume that the shipowner and the jetty owner intended respectively to bear—in order that such a minimum of efficacy should be secured for the transaction, as both parties must have intended it to bear? Assume that the berth outside had been absolutely under the control of the owners of the jetty, that they could have repaired it and made it fit for the purpose of the unloading and the loading. If this had been the case, then the case of *The Mersey Docks Trustees v Gibbs*[6] shews that those who owned the jetty, who took money for the use of the jetty, and who had under their control the locus in quo, would have been bound to take all reasonable care to prevent danger to those who were using the jetty—either to make the berth outside good, or else not to invite ships to go there—either to make the berth safe, or to advise persons not to go there. But there is a distinction in the present instance. The berth outside the jetty was not under the actual control of the jetty owners. It is in the bed of the river, and it may be said that those who owned the jetty had no duty cast upon them by statute or common law to repair the bed of the river, and that they had no power to interfere with the bed of the river unless under the licence of the Conservators. Now it does make a difference, it seems to me, where the entire control of the locus in quo—be it canal, or be it dock, or be it river berth—is not under the control of the persons who are taking toll for accommodation which involves its user, and, to a certain extent, the view must be modified of the necessary implication which the law would make about the duties of the parties receiving the remuneration. This must be done exactly for the reason laid down by Lord Holt in his judgment in *Coggs v Bernard*[7], where he says "it would be unreasonable to charge persons with a trust further than the nature of the thing puts it in their power to perform." Applying that modification, which is one of reason, to this case, it may well be said that the law will not imply that the persons who have not the control of the place have taken reasonable care to make it good, but it does not follow that they are relieved from all responsibility. They are on the spot. They must know that the jetty cannot be used unless reasonable care is taken, if not to make it safe, at all events to see whether it is safe. No one can tell whether reasonable safety has been secured except themselves, and I think if they let out their jetty for use they at all events imply that they have taken reasonable care to see whether the berth, which is the essential part of the use of the jetty, is safe, and if it is not safe, and if they have not taken such reasonable care, it is their duty to warn persons with whom they have dealings that they have not done so. This is a business transaction as to which at any moment the parties may make any bargain they please, and either side may by the contract throw upon the other the burden of the unseen and existing danger. The question is what inference is to be drawn where the parties are dealing with each other on the assumption that the negotiations are to have some fruit, and where they say nothing about the burden of this kind of unseen peril, leaving the law to raise such inferences as are reasonable from the very nature of the transaction. So far as I am concerned I do not wish it to be understood that I at all consider this is a case of any duty on the part of the owners of the jetty to see to the access to the jetty being kept clear. The difference between access to the jetty and the actual use of the jetty seems to me, as Mr Finlay says it is, only a question of degree, but when you are dealing with implications which the law directs, you

6 *The Mersey Docks Trustees v Gibbs* (1866) LR 1 HL 93, [1861-73] All ER Rep 397, 14 LT 677.

7 *Coggs v Bernard* Ld Raym 909 (918), 1 Sm LC, 9th ed, 201 (216) (QB).

cannot afford to neglect questions of degree, and it is just that difference of degree which brings one case on the line and prevents the other from approaching it. I confess that on the broad view of the case I think that business could not be carried on unless there was an implication to the extent I have laid down, at all events in the case where a jetty like the present is so to be used, and, although the case is a novel one, and the cases which have been cited do not assist us, I feel no difficulty in drawing the inference that this case comes within the line.

Lord Esher MR and Fry LJ agreed with Bowen LJ that the appeal should be dismissed.

[10-8] The plaintiffs succeeded in their claim because a term was implied into the contract that the defendants had taken reasonable care to see whether the berth was safe or to give warning that they had not taken such care. Without such a term, the contract would not have possessed business efficacy; it is hardly credible that it, in all the circumstances, it was commercially efficacious for the shipowner to enter into the contract anticipating that the arrangement might damage its vessel.

[10-9] By way of contrast, one may consider *Yau Chin Kwan v Tin Shui Wai Development Ltd*.[8] There was a written term requiring the defendant to complete a building project by a specified date. Failure to complete by the deadline would permit the plaintiffs to rescind the contract within 28 days, failing which they would be treated as having elected to wait for completion. The project was not completed by the deadline, but the plaintiffs were unaware of this and did not rescind within the prescribed period prescribed by the contract. Instead, they rescinded some 16 months after the project completion deadline. The plaintiffs claimed recovery of their deposit. According to the plaintiffs, the contract impliedly required the defendant to (a) inform the plaintiffs of the state of completion within 28 days of the project completion deadline, (b) provide timely information on the development's progress to enable the plaintiffs to exercise their right of rescission, and (c) answer the plaintiffs' questions as to the completion of the development (although the plaintiffs never, in fact, asked any questions as to the completion of the development). The Hong Kong Court of Appeal rejected implied terms (a) and (b), on the basis that the contract could work without them, especially because implied term (c) would provide all the information the plaintiffs might need.

[10-10] According to Bowen LJ in *The Moorcock*, the implied term must not only be necessary in order to give the contract business efficacy, it must also be one to which the parties would have agreed had they turned their minds to the matter at the time of concluding the agreement. The existence of conflicting commercial motives or interests might mean that reasonable persons in the position of the parties probably would not have been able to agree a term had

8 *Yau Chin Kwan v Tin Shui Wai Development Ltd* [2003] 2 HKLRD 1, [2002] HKCU 1162 (CA).

the printed exemption clause stated that the dry cleaner was 'not liable for any damage howsoever arising'. When the dress was stained, the dry cleaner could not rely on the printed clause, notwithstanding that the misrepresentation was literally true and did not falsify any part of the printed clause.[47]

2.5 Inducement to conclude contract and failure to verify

2.5.1 Inducement

[14-38] A misrepresentation will not be operative (or 'material') unless it was one of the inducements causing a reasonable person in the position of the representee to conclude the contract.[48] The test as to whether a misrepresentation is material was articulated by Scott J in *Museprime Properties Ltd v Adhill Properties Ltd*:[49]

> A representation is material, in my opinion, if it is something that induces the person to whom it is made, whether solely or in conjunction with other inducements, to contract on the terms on which he does contract. I would gratefully adopt the view expressed in *Goff & Jones on the Law of Restitution* 3rd Ed, at p 168, which reads,
>
> "In our view any misrepresentation which induces a person to enter into a contract should be a ground for rescission of that contract. If the misrepresentation would have induced a reasonable person to enter into the contract then the court will, as we have seen, presume that the representee was so induced and the onus will be on the representor to show that the representee did not rely on the misrepresentation either wholly or in part. If, however, the misrepresentation would not have induced a reasonable person to contract, the onus will be on the representee to show that the misrepresentation induced him to act as he did. [...]"

[14-39] A misrepresentation will, therefore, be rebuttably presumed to have induced the representee to enter into the contract if it would have so induced a reasonable person in the position of the representee. In order to rebut such a presumption, the representor must prove either that the representee knew the statement to be false, or that he otherwise placed no reliance on it in concluding the contract[50] (because eg., the misrepresentation had not come to

47 *Curtis v Chemical Cleaning and Dyeing Co Ltd* [1951] 1 KB 805, [1951] 1 All ER 631, [1951] 1 TLR 452. See **[13-27]**.

48 *Master Yield Ltd v Ho Foon Yung Anesis* [2013] 6 HKC 520 (CA), para 22 (Lam JA, Cheung and Kwan JJA agreeing), emphasising that the test is not the misrepresentation's effect on a reasonable bystander.

49 *Museprime Properties Ltd v Adhill Properties Ltd* [1990] 2 EGLR 196 at 201–202, cited with approval in *Master Yield Ltd v Ho Foon Yung Anesis* [2013] 6 HKC 520 (CA), para 21 (Lam JA, Cheung and Kwan JJA agreeing).

50 *Redgrave v Hurd* (1881) LR 20 Ch D 1, [1881-85] All ER Rep 77 (CA, Eng).

his notice,[51] was made after the contract was concluded,[52] or he relied on his own information[53]).

2.5.2 Failure to verify

[14-40] A misrepresentation may, moreover, be operative notwithstanding that the representee could have checked its veracity but failed to do so.

Redgrave v Hurd

Court of Appeal (England and Wales)
(1881) LR 20 Ch D 1; [1881–85] All ER Rep 77

Redgrave was a solicitor who placed an advertisement in the *Law Times* seeking a partner for his practice who would not object to buying his residence. Hurd replied to the advertisement. Redgrave told Hurd on two different occasions that the practice was bringing in about £300 per annum or about £300 to £400 per annum. Redgrave showed Hurd summaries of the practice's business over the three previous years which disclosed an annual income of slightly less than £200. He told Hurd that the difference could be explained by the fact that the practice also generated additional income not included in the summaries, but which he could verify for himself by going through a bundle of papers shown to him. Hurd declined the invitation to check the papers. Had he done so, he would have discovered that they disclosed virtually no additional income. Hurd concluded a contract under which he agreed to purchase Redgrave's house for £1,600. He paid an immediate £100 deposit. Shortly thereafter, Hurd discovered the truth about the practice's financial position and refused to complete the transaction. Redgrave brought proceedings claiming specific performance or damages, and Hurd counterclaimed for return of his deposit on the ground of rescission for misrepresentation. Redgrave argued that there had been no misrepresentation because he had presented Hurd with the opportunity to verify the financial position of the practice, but Hurd had declined to do so. Redgrave succeeded at trial, and Hurd appealed.

Jessell MR:

...

... If a man is induced to enter into a contract by a false representation it is not a sufficient answer to him to say, 'If you had used due diligence you would have found out that the statement was untrue. You had the means afforded you of discovering its falsity, and did not choose to avail yourself of them.' I take it to be a settled doctrine of equity, not only as regards specific performance but also as regards rescission, that this is not an answer ... Nothing can be plainer, I take

51 *Ex parte Biggs* (1859) 28 LJ Ch 50; *Horsfall v Thomas* (1862) 1 H & C 90, 158 ER 813 (misrepresentation by conduct in concealing defect in a firearm, but purchaser did not inspect the item before purchase).

52 *Hunt v Optima (Cambridge) Ltd* [2014] EWCA Civ 714, [2014] All ER (D) 70 (Aug), [2015] 1 WLR 1346 (negligent misstatements in architects' certificates of completion not material because issued after contract of sale.

53 *Attwood v Small* [1835–42] All ER Rep 258, (1838) 6 Clark & Finnelly 232, 7 ER 684 (misrepresentations concerning capacity of mines and ironworks not material because representee relied on his own inspections leading him to conclude the statements were true).

it, on the authorities in equity than that the effect of false representation is not got rid of on the ground that the person to whom it was made has been guilty of negligence.

One of the most familiar instances in modern times is where men issue a prospectus in which they make false statements of the contracts made before the formation of a company, and then say that the contracts themselves may be inspected at the offices of the solicitors. It has always been held that those who accepted those false statements as true were not deprived of their remedy merely because they neglected to go and look at the contracts. Another instance with which we are familiar is where a vendor makes a false statement as to the contents of a lease, as, for instance, that it contains no covenant preventing the carrying on of the trade which the purchaser is known by the vendor to be desirous of carrying on upon the property. Although the lease itself might be produced at the sale, or might have been open to the inspection of the purchaser long previously to the sale, it has been repeatedly held that the vendor cannot be allowed to say, 'You were not entitled to give credit to my statement.' It is not sufficient, therefore, to say that the purchaser had the opportunity of investigating the real state of the case, but did not avail himself of that opportunity. …

… the learned Judge came to the conclusion either that the Defendant did not rely on the statement, or that if he did rely upon it he had shewn such negligence as to deprive him of his title to relief from this Court. As I have already said, the latter proposition is in my opinion not founded in law, and the former part is not founded in fact; I think also it is not founded in law, for when a person makes a material representation to another to induce him to enter into a contract, and the other enters into that contract, it is not sufficient to say that the party to whom the representation is made does not prove that he entered into the contract, relying upon the representation. If it is a material representation calculated to induce him to enter into the contract, it is an inference of law that he was induced by the representation to enter into it, and in order to take away his title to be relieved from the contract on the ground that the representation was untrue, it must be shewn either that he had knowledge of the facts contrary to the representation, or that he stated in terms, or shewed clearly by his conduct, that he did not rely on the representation. If you tell a man, 'You may enter into partnership with me, my business is bringing in between £300 and £400 a year,' the man who makes that representation must know that it is a material inducement to the other to enter into the partnership, and you cannot investigate as to whether it was more or less probable that the inducement would operate on the mind of the party to whom the representation was made. Where you have neither evidence that he knew facts to shew that the statement was untrue, or that he said or did anything to shew that he did not actually rely upon the statement, the inference remains that he did so rely, and the statement being a material statement, its being untrue is a sufficient ground for rescinding the contract. For these reasons I am of opinion that the judgment of the learned Judge must be reversed and the appeal allowed.

Baggallay LJ and Lush LJ concurred.

[14-41] As *Redgrave* indicates, a representee's failure to verify a statement will not negate a misrepresentation, even if such failure is negligent. A representee is thus entitled to rely on the veracity of a statement made to him. If the representee knew the statement was untrue, it will not constitute a misrepresentation because the representee will have placed no reliance on it.

[14-42] In *Welltech Investment Ltd v Easy Fair Industries Ltd*,[54] the plaintiff agreed to purchase premises within a commercial building in Kowloon. In pre-contractual negotiations, the defendant incorrectly represented through its property agent that it had exclusive access to certain areas within the building and that this right would be conveyed to the plaintiff. The true position could have been ascertained had the plaintiff bothered to check the Deed of Mutual Covenant and sub-Deed of Mutual Covenant which were readily available. The plaintiff was nevertheless entitled to rescind the contract. According to Le Pichon J:[55]

> Although the DMC and the sub-DMC were provided to the purchaser's solicitors prior to [the contract's conclusion], the fact that the purchaser had an opportunity of discovering the falsity of the representations is no defence. It has long been the law that where a person induces another to enter into a contract with him by a material representation which is untrue, it is no defence to an action for rescission that the person to whom the representation was made had the means of discovering, and might, with reasonable diligence, have discovered, that it was untrue: *Redgrave v Hurd* (1881) 20 Ch D 1. I reject the submission that it was in any way incumbent on the purchaser to have asked for the perusal of the DMC and sub-DMC or to have sought legal advice prior to signing the provisional agreement. It is not a defence that had he done so he would have discovered the falsity of the representations.

[14-43] Where, however, the representee does take steps to verify a statement, he will not be able to claim relief for misrepresentation in respect of that statement. It will, in such circumstances, be impossible for the representee to maintain that he relied on the statement in concluding the contract. In *Attwood v Small*,[56] the defendant sold some mines and iron works to the plaintiffs. In the course of negotiations, the defendant made some statements about the capacity of the properties. The plaintiffs took steps to verify the defendant's statements by inspecting the properties and examining the accounts. The result was that the plaintiffs were satisfied that the defendant's statements were true, and concluded the contract. Subsequently, the plaintiffs discovered that the statements were in fact untrue. The plaintiffs' action based on misrepresentation was unsuccessful because, having relied on the results of their own investigations, they no longer relied on the defendant's statements.

2.6 Multiple inducements to conclude contract

[14-44] It is not necessary that the misrepresentation, in order to be operative, must have been the sole inducement for the representee to conclude the contract. In *Edgington v Fitzmaurice*,[57] one of the defences raised was that the plaintiff had reasons to conclude the contract other than the misrepresentation

54 *Welltech Investment Ltd v Easy Fair Industries Ltd* [1996] 4 HKC 711 (HC).
55 ibid at 720.
56 *Attwood v Small* [1835–42] All ER Rep 258, (1838) 6 Clark & Finnelly 232.
57 *Edgington v Fitzmaurice* (1885) 29 Ch D 459 (Ch). See para **[14-13]** above.

4.5 Onus of proof

[15-78] The onus of establishing an operative mistake rests on the party asserting it. In *Centrovincial Estates plc v Merchant Investors Assurance Co Ltd*,[116] the plaintiffs were the leaseholders of commercial premises, part of which had been underlet to a tenant that had in turn underlet part of it to the defendants at an annual rent of £68,320. The plaintiffs were about to become the direct lessors of the defendants and at the same time the defendants' annual rent was due to be adjusted to reflect current market rents. The adjustment was subject to a proviso in the underlease that the rent would not decrease. The underlease provided that the parties were to agree the new rent in accordance with prevailing market rates or, in the absence of such agreement, a valuer would decide the new rent by reference to market rates. The plaintiffs' solicitors wrote to the defendants proposing a revised annual rent of £65,000, which the defendants swiftly accepted. The solicitors then realised that their offer letter contained an error and that the proposed new rent should have been £126,000. The defendants regarded the plaintiffs as bound to a new annual rent of £65,000 in accordance with the agreement, but the plaintiffs argued that it was tainted by unilateral mistake and void. The plaintiffs sought declaratory relief that no binding agreement as to rent had been made and that the determination of market rent should be referred to a surveyor in accordance with the underlease. Summary judgment was ordered, against which the defendants appealed. In allowing the appeal, the English Court of Appeal observed:[117]

> … in the absence of any proof, as yet, that the defendants either knew or ought reasonably to have known of the plaintiffs' error at the time when they purported to accept the plaintiffs' offer, why should the plaintiffs now be allowed to resile from that offer? It is a well-established principle of the English law of contract that an offer falls to be interpreted not subjectively by reference to what has actually passed through the mind of the offeror, but objectively, by reference to the interpretation which a reasonable man in the shoes of the offeree would place on the offer. It is an equally well-established principle that ordinarily an offer, when unequivocally accepted according to its precise terms, will give rise to a legally binding agreement as soon as acceptance is communicated to the offeror in the manner contemplated by the offer, and cannot thereafter be revoked without the consent of the other party.

4.6 Contractual provision for mistake

[15-79] Where the contract itself makes provision for what is to occur in the event of an operative unilateral mistake, that provision will prevail over the general law on mistake. The contract's terms must, however, clearly indicate an intention by the parties to make alternative provision to the general law on mistake.

116 *Centrovincial Estates plc v Merchant Investors Assurance Co Ltd* [1983] Com LR 158 (CA, Eng).

117 Per Slade LJ delivering the judgment of the court, the other member of which was Robert Goff LJ.

City University of Hong Kong v Blue Cross (Asia-Pacific) Insurance Ltd

Court of First Instance
[2001] 1 HKC 463

For the facts, see **[3-33]** above.

Deputy Judge Woolley:

[decided that, but for CityU's breach of clause 8, Blue Cross would have been obliged not to withdraw its tender, and continued]

I would, however, go further and look at the position at common law. It has long been held that a mistake as to the terms of a contract, if known to the other party, may avoid the contract. Price is a term of a contract, and where, as here, the plaintiff must have known that the price had been quoted in error, could not make a binding contract by accepting it. Mr Ma [SC, counsel for the plaintiff] says that where the terms of a contract deal with the question of error, then that overrides these provisions. That may be so where they do so clearly, with the stated intention of overriding the provisions. But that is not the position here. The wording of cl 8 at first caused me some disquiet in the light of the inconsistency I referred to above, in appearing to seek confirmation of a tender which the defendant was obliged to abide by. However, if it is looked at in the light of a provision *accepting* the common law position, namely that the contract can be avoided by errors known to the plaintiff, but providing that they can protect their position by asking the defendant to confirm, then there is no inconsistency and the clause makes good sense. That is what I accept cl 8 must mean, it is for the protection of the plaintiff not the defendant, as the defendant's position, of making an offer containing a mistake as to its terms of which the other side is aware, is already protected under common law.

As will be clear from my findings above, the facts here show that there was a mistake made by the defendant as to the terms of the tender, the plaintiff was aware of it, and, in the absence of the plaintiff seeking the protection of clause 8, the defendant was entitled to avoid the contract as they did.

…

For the reasons given above the plaintiff's claim will be dismissed and judgment given for the defendant by way of a declaration that the contract of insurance between them and the plaintiff was null and void and of no effect.

[15-80] Clause 8 in CityU's invitation to tender did not displace the general common law on unilateral mistake because, properly construed, its purpose was to protect CityU's position as non-mistaken offeree, rather than Blue Cross' position as mistaken offeror. Had CityU complied with clause 8, it would have protected itself against avoidance of the contract. However, the failure by CityU to observe clause 8 could not affect Blue Cross' position under the general common law, and it therefore remained entitled to avoid the contract for unilateral mistake.

4.7 Remedies for unilateral mistake

4.7.1 Rescission

[15-81] On one reading of the English Court of Appeal's decision in *Great Peace*, equity is expelled not only from common mistake, but also from

unilateral mistake because there is no logical basis for treating the two species of mistake differently. On this interpretation, either actual or constructive knowledge of the mistaken party's error by the non-mistaken party would be sufficient to establish unilateral mistake at common law and render the agreement void at common law.[118] Such, indeed, was the approach of Rajah JC at trial in *Chwee Kin Keong*.[119]

[15-82] On a narrower reading of *Great Peace*, however, equity is expelled only from the realm of common mistake and retains a presence in unilateral mistake. Although the point has not been finally determined in either England[120] or Hong Kong, the Singapore Court of Appeal in *Chwee Kin Keong* has emphatically embraced the narrower interpretation of *Great Peace*, thereby preserving a role for equity in unilateral mistake.[121]

[15-83] According to the *Chwee Kin Keong* appeal court, the key concept delineating unilateral mistake at common law from unilateral mistake in equity is the type of knowledge possessed by the non-mistaken party. If that party possessed actual knowledge of the error, the mistake exists at common law and the contract is void. If on the other hand the non-mistaken party's knowledge is merely constructive, then the agreement may be liable to rescission in equity, but only if the non-mistaken party has also engaged in inequitable conduct which may include failing to draw his suspicions of a mistake to the other party's attention.

4.7.2 Rectification

[15-84] The unilaterally mistaken party might prefer not to avoid the contract, but to enforce it. In that case, he may seek an order for rectification giving effect to the agreement as he understood it.[122]

4.7.3 Specific performance

[15-85] The non-mistaken party might seek to enforce the contract by specific performance, a remedy in equity that will be refused where the contract is void at common law. Thus, if an agreement is void for common mistake, specific

118 Eg, *Hartog v Colin & Shields* [1939] 3 All ER 566 (KB); see J Cartwright, 'Unilateral Mistake in the English Courts: Reasserting the Traditional Approach' [2009] *Singapore Journal of Legal Studies* 226–234, at p 229.

119 *Chwee Kin Keong v Digilandmall.com Pte Ltd* [2004] 2 SLR 594 (HC, Sing).

120 The judgment of Aikens J in *Statoil ASA v Louis Dreyfus Energy Services LP (The 'Harriette N')* [2008] EWHC 2257 (Comm), [2009] 1 All ER (Comm) 1035, [2008] 2 Lloyd's Rep 685 (para 105) postulates that *Great Peace* precludes only an equitable jurisdiction to rescind a contract for a mistake that (i) is not the subject of a contractual term, and (ii) does not result from a misrepresentation. *The 'Harriette N'* does not go so far as to preclude the possibility of a unilateral mistake in equity as to the existence or meaning of a contractual term.

121 *Chwee Kin Keong v Digilandmall.com Pte Ltd* [2005] 1 SLR 502 (CA, Sing), para 74.

122 See para **[15-113]** et seq below.

performance will not be granted.[123] The rationale is, of course, that there is simply no contract to be performed.

[15-86] Specific performance may be refused to the non-mistaken party even where the contract is not void for unilateral mistake at common law, either because the non-mistaken party lacked knowledge of his counterparty's error or because the mistake was not fundamental to the agreement. In such cases, specific performance may be refused where granting the remedy would lead to greater hardship than would be caused by refusing it.

[15-87] In *Malins v Freeman*, for instance, the defendant attended an auction for five separate lots of land. He successfully bid for one lot, but deceived himself into believing that he was bidding for a different lot. The Court of Chancery refused the plaintiff's application for specific performance, leaving him to rely only on his right to common law damages:

> 'In cases of specific performance the Court exercises a discretion; and, knowing that a party may have such compensation as a jury will award him in the shape of damages for the breach of contract, will not in all cases decree a specific performance'.[124]

[15-88] In *Tamplin v James*, by contrast, specific performance was granted where the mistaken defendant successfully bid for a lot of land that was less extensive than he had deceived himself into believing; 'for the most part the cases where a Defendant has escaped on the ground of a mistake not contributed to by the Plaintiff, have been cases where a hardship amounting to injustice would have been inflicted upon him by holding him to his bargain, and it was unreasonable to hold him to it'.[125] It is no easy matter to reconcile *Malins* and *Tamplin*, although Treitel makes a valiant and plausible attempt by postulating that 'it is a "hardship amounting to injustice" to force a person to take one property when he thinks he has bought another, but not to force a person to take a property which is less extensive than he thought'.[126]

[15-89] Even where specific performance is granted, it may be made subject to such conditions as appear necessary to do justice between the parties. This is an unsurprising consequence of the remedy's existence in equity.

In *Baskcomb v Beckwith*,[127] for instance, a vendor sold an estate in several lots on condition that each purchaser covenant not to build a public house or conduct any trade on his lot. Unbeknownst to one of the purchasers, the vendor retained a small portion of the estate himself on which he intended to build a

123 *Webster v Cecil* (1861) 30 Beavan 62, 54 ER 812; *Pateman v Pay* (1974) 232 Estates Gazette 457.

124 *Malins v Freeman* (1837) 2 Keen 25 at 34, 48 ER 537 at 541 (Ch).

125 *Tamplin v James* (1880) 15 Ch D 215 at 221, [1874–80] All ER Rep 560 at 562 (CA, Eng) (James LJ).

126 Edwin Peel, *Treitel: The Law of Contract* (14th edn, Sweet & Maxwell, 2015) p 384.

127 *Baskcomb v Beckwith* (1869) LR 8 Eq 100.

public house. When the purchaser learned of this, he refused to proceed with the transaction, and the vendor sought specific performance. Lord Romilly MR granted specific performance, subject to a condition that the vendor give a covenant on the same terms required of the purchaser:

> 'It is of the greatest importance that it should be understood that the most perfect truth and the fullest disclosure should take place in all cases where the specific performance of a contract is required, and that, if this fails, even without any intentional suppression, the Court will grant relief to the man who has been thereby deceived, provided he has acted reasonably and openly'.[128]

Were the vendor to have declined an order on such terms, he would have been left only with his remedy of damages at common law.

5. Identity Mistake

[15-90] Identity mistake is closely related to unilateral mistake. An identity mistake arises where A intends to enter into a contract with B, but instead mistakenly makes an agreement with C. As indicated at the outset of this chapter, this type of situation almost invariably arises where a rogue (C) impersonates someone (B) with whom A is willing to contract. C then acquires, on credit terms or with a worthless cheque, goods from A. Before making full payment to A, C parts with the goods for value to a third party who is innocent of C's perfidy. At this point in the sad narrative, C typically vanishes with the proceeds of his transaction with the third party, and either cannot be found or is not good for the value of A's loss. A then seeks to recover the goods or their value from the third party on the grounds that C had no title that he could pass. The issue between A and the third party is whether there was ever a valid contract between A and C. A will argue that, because he intended to contract only with B, no contract with C ever came into existence and no title in the goods were passed to C. The third party will argue that the true identity of C was not essential to A and that the facts raise, at most, fraudulent misrepresentation making the contract with the rogue voidable, but not void. Thus, C's two victims are locked in dispute with each other. Largely because of Hong Kong's effective and long-standing system of mandatory identification cards, this variety of mistake is of limited practical significance in the jurisdiction.

5.1 Agreement by correspondence

[15-91] Where the parties have concluded their agreement by correspondence, each case must be assessed on its facts in order to determine whether the true identity of the rogue was essential to the defendant's contractual intention. In *Cundy v Lindsay*,[129] the plaintiffs were manufacturers of handkerchiefs who

128 ibid at 109.
129 *Cundy v Lindsay* (1878) 3 App Cas 459, [1874–80] All ER Rep 1149 (HL).

received a written order for a large quantity from Alfred Blenkarn at 35 Wood Street, Cheapside in London. Blenkarn signed his name to the order in such a way that it looked as though the order came from Blenkiron & Son, a reputable firm carrying on business at 123 Wood Street, Cheapside. The plaintiffs delivered the goods to 35 Wood Street, where Blenkarn took possession without paying. He then purported to sell the handkerchiefs to numerous *bona fide* customers, including the defendants who took 250 dozen. Blenkarn was convicted of fraud, and the plaintiffs brought an action for the tort of conversion against the defendants. The House of Lords accepted that the plaintiffs had intended to contract only with Blenkiron & Son, and that there was therefore never any contract with Blenkarn. Consequently, title to the goods had not passed to Blenkarn who, in turn, could not pass title to the defendants. The plaintiffs therefore succeeded in their claim.

[15-92] The English Court of Appeal decision in *King's Norton Metal Co Ltd v Edridge, Merrett & Co Ltd*[130] provides a useful contrast to *Cundy*. Wallis, posing as Hallam & Co of Sheffield, sent a written order to the plaintiffs for a ton of brass rivet wire. The plaintiffs supplied the goods to 'Hallam & Co' in Sheffield, and Wallis on sold them to the defendants. Wallis did not pay the plaintiffs, who then brought an action for conversion against the defendants. On this occasion, the defendants succeeded. This was because Hallam & Co did not exist and the plaintiffs had been willing to enter into a contract with anyone who placed an order.

5.2 Face-to-face agreement

[15-93] Both *Cundy* and *King's Norton Metal* involved transactions by correspondence; the plaintiffs had not actually met the rogue. In *Phillips v Brooks Ltd*,[131] a rogue entered the plaintiff's jewellery shop. He selected some items of jewellery, including a ring for £450. Posing as Sir George Bullough, the rogue wrote a cheque in Bullough's name. The plaintiff had heard of Sir George Bullough, and allowed the rogue to leave the shop with the ring in exchange for the cheque. The cheque was dishonoured, and the plaintiff attempted to recover the ring from the defendant pawnbrokers to whom the rogue had sold it for £350. The plaintiff's action failed. The King's Bench Division held that the plaintiff had intended to sell the ring to the person actually standing in front of him in the shop, notwithstanding that he would not have done so had he known the rogue's true identity.

[15-94] To similar effect is *Lewis v Averay*[132] in which the plaintiff advertised his motor car for sale in a newspaper. In response to the advertisement, a rogue came to the plaintiff's flat posing as Richard Greene, a famous British actor. The rogue offered to pay for the car by cheque, but the plaintiff was reluctant to accept a cheque. When the rogue insisted, the plaintiff asked for proof of the

130 *King's Norton Metal Co Ltd v Edridge, Merrett & Co Ltd* (1897) 14 TLR 98 (CA, Eng).
131 *Phillips v Brooks Ltd* [1919] 2 KB 243, [1918–19] All ER Rep 246 (KB).
132 *Lewis v Averay* [1971] 3 All ER 907 (CA, Eng).

[16-69] Where the loan is advanced to a company of which the surety is a shareholder, and even where the surety is a director or secretary of the company, the bank is still put on inquiry because 'shareholding interests, and the identity of the directors, are not a reliable guide to the identity of the persons who have the conduct of the company's business'.[124] In *Re Lai Yin Shan, ex parte Hong Kong and Shanghai Banking Corp Ltd*,[125] the appellant was a 30 percent shareholder, a director and the secretary of a company in which her husband was also a shareholder and director. The respondent bank made loans to the company, and the appellant gave personal guarantees in respect of those loans. The bank obtained a bankruptcy order against the appellant after the company defaulted. The bankruptcy order was granted prior to the judgment in *Etridge*, but the appeal was heard after *Etridge*. At the hearing of the bankruptcy petition, the court found that the appellant had concluded the surety agreements while operating under the undue influence of her husband in whom she reposed trust and confidence in respect of her financial affairs and who had misrepresented the nature of the documents to her. The judge at the petition hearing held, however, that the bank was not put on inquiry of the undue influence as the loan was to a company in which the appellant was a substantial shareholder and appeared to play an active role. The loan therefore appeared to be one which was in substance made with the appellant and her husband jointly. The Hong Kong Court of Appeal set aside the bankruptcy order on the basis that the appellant's formal roles in the company were not a sufficiently reliable basis upon which to conclude that the loan was in substance made to the appellant and her husband jointly, and the bank had failed to take the necessary steps to advise and warn the appellant as to the nature and consequences of the transaction.

[16-70] Where, however, the loan is advanced to the spouses jointly, the bank is not put on inquiry unless it is aware the loan is being made for the purposes of one spouse only, as distinct from their joint purposes.[126]

3. Unconscionability

[16-71] It is a central pillar of the common law's conception of freedom of contract that the courts will not intervene in order simply to save a person from an improvident bargain which he has freely made. The attitude of equity has, as ever, been less rigid than that of the common law, and there are limited circumstances in which equity will relieve a party from a disadvantageous

124 *Royal Bank of Scotland v Etridge (No 2)* [2002] 2 AC 773, [2001] 4 All ER 449, [2001] 3 WLR 1021, [2002] 1 Lloyd's Rep 343 at para 49 (HL).

125 *Re Lai Yin Shan, ex parte Hong Kong and Shanghai Banking Corp Ltd* [2002] 3 HKLRD 500, [2002] HKCU 1135 (CA).

126 See eg *ABN Amro Bank NV v Manharlal Trikamas Mody* [2002] HKCU 1339 (unreported, HCMP 4724/2001, 7 November 2002) (CFI) para 21.

bargain notwithstanding that his assent has been given without the freedom-diminishing taint of misrepresentation, mistake, duress or undue influence. In the words of Treitel:[127]

> Equity can give relief against unconscionable bargains in certain cases in which one party is in a position to exploit a particular weakness of the other. The burden of justifying such a transaction is on the former party.

[16-72] In support of this proposition, Treitel cites *Earl of Aylesford v Morris*[128] in which an expectant heir of a fortune borrowed, within months of attaining his majority, a very large sum of money at an annual interest rate of 60 percent. The young man's lack of experience and evident weaknesses, combined with the exceptional terms of the bargain itself, prompted the court to reduce the annual rate of interest to 5 percent. Lord Selborne LC observed that the courts will protect weaker parties from transactions with 'those who trade on the follies and vices of unprotected youth, inexperience, and moral imbecility' and identified the money lender's conduct as involving 'an unconscientious use of the power arising out of these circumstances and conditions.'[129]

[16-73] In England, it was for a while thought that a doctrine of unconscionability might be made to rest on a broad concept of 'inequality of bargaining power' advanced by Lord Denning MR in several cases such as *Lloyds Bank Ltd v Bundy*.[130] This rather amorphous and potentially destabilising notion did not, however, find much judicial support.

3.1 Unconscionability in equity

3.1.1 Three requirements

[16-74] Compared to other areas of contract doctrine, there has until recently been a relative dearth of authority or doctrine on unconscionability in either England or Hong Kong.[131] Unconscionability gained earlier traction in Australia, from which jurisdiction emanate both the statutory models for Hong Kong's legislation on unconscionable contracts[132] and the leading Commonwealth authority on unconscionability.

127 Edwin Peel, *Treitel: The Law of Contract* (14th edn, Sweet & Maxwell, 2015) p 524.

128 *Earl of Aylesford v Morris* (1873) LR 8 Ch App 484, [1861–73] All ER Rep 300 (CA, Ch).

129 *Earl of Aylesford v Morris* (1873) LR 8 Ch App 484 at 490, [1861–73] All ER Rep 300 at 303 (CA, Ch); There is, however, no presumption that a transaction for the sale of an expectancy interest in another's estate is *prima facie* unconscionable: *Tong Kwok Cheong v Tong Wai Lin* [2014] 1 HKLRD 339, [2013] HKCU 2712 (CA).

130 *Lloyds Bank Ltd v Bundy* [1975] QB 326, [1974] 3 All ER 757, [1974] 3 WLR 501 (CA, Eng).

131 Indeed, in *OTB International Credit Card Ltd v Au Sai Chak Michael* [1980] HKC 219 (CA), the court declined to decide the case on the basis of unconscionability, finding no authority for such a doctrine.

132 Unconscionable Contracts Ordinance (Cap 458). See para **[16-91]** below.

or the Developer. In other words, the applicants will not be or become beneficial owners of the relevant sections or lots of the houses erected on them.

It is evident that neither of the defendants is eligible to apply for a grant under the Small House Policy. The concessionary terms and special privileges that become available as a result of the applications being successful will be for the benefit of the defendants and not the applicants under the Deed. In essence, the arrangement under the Deed is no different from the development scheme considered in *Best Sheen Development Ltd v Official Receiver*.[12] Indeed, they share many common features.

Under the Deed, an applicant will inevitably be making a representation in his application as to the legal and beneficial ownership of the section or lot in respect of which the application is made and which is untrue. Although the tort of misrepresentation is not committed until an application is made, in effect the Deed is an agreement to procure villagers to make applications which necessarily involve misrepresenting to the Government the beneficial ownership of the section or lot in question. That being so, I agree this is a further reason why the Deed cannot be performed without the commission of a civil wrong. In my judgment, it is an additional reason rendering the Deed unlawful and unenforceable under common law.

Order

In my judgment, the Deed is plainly unenforceable on public policy grounds because performance according to its terms necessarily involves the swearing of false declarations and the making of misrepresentations to Government.

For these reasons, I would set aside the judgment below and enter final judgment against the first defendant …

Rogers VP agreed with Le Pichon JA.

[17-10] The contract in *Chung Mui Teck* was unenforceable because it depended on the performance of acts by third parties which, in all the circumstances, necessarily required them to commit two legal wrongs simultaneously. By declaring that, in effect, they were the sole beneficial owners of the property, they would necessarily have been making a false statutory declaration in order to obtain a benefit (a criminal offence) and a tortious misrepresentation to the Government.[13] The contract was thus illegal and unenforceable.

3. Contracts Contrary to Public Morality

[17-11] Contracts injurious to sexual morality may also be affected by violation of public policy. Falling within this category are not only contracts to perform a sexually immoral act, but also contracts to supply goods or services

12 ibid.

13 Where, however, the required acts by third parties can be performed without the necessity of any unlawful conduct on their part and without any intention by the contracting parties that unlawful conduct would occur, it is unlikely that the contract would be rendered unenforceable merely because the third parties chose an unlawful mode of performing the acts. As to the role of intention in the enforceability of illegal contracts, see para **[17-88]** below.

which, to the knowledge of the supplier, will be used to further the commission of such an act.

[17-12] In *Pearce v Brooks*,[14] the plaintiffs sold a carriage to a prostitute who was to pay by instalments. The plaintiffs knew that the prostitute intended to use the carriage in her trade. The prostitute did not pay the second instalment and returned the carriage to the plaintiffs in a damaged condition. The plaintiffs' action for breach of contract or the cost of damage to the carriage was unsuccessful. According to Pollock CB:[15]

> … any person who contributes to the performance of an illegal act by supplying a thing with the knowledge that it is going to be used for that purpose, cannot recover the price of the thing so supplied … the rule which is applicable to the matter is *ex turpi causa non oritur actio*,[16] and whether it is an immoral or an illegal purpose in which the plaintiff has participated, it comes equally within the terms of the maxim and the effect is the same; no cause of action can arise out of one or the other.

[17-13] The principle identified in *Pearce* applies to immoral acts even if they are not illegal, so that a contract the claimant knows advances an immoral purpose will be unenforceable. The same approach has been taken in Hong Kong.

The Ki Hing Lau v The Shun Loong Lee Firm

Full Court of the Supreme Court
(1910) 5 HKLR 83; [1910] HKCU 4

The Shun Loong Lee Firm supplied sharks' fins to a brothel known as the Ki Hing Lau. When the brothel failed to pay Shun Loong Lee's bill, they brought proceedings to recover the contract price. At trial, Shun Loong Lee's principal witness testified: *'I am the manager of the plaintiff firm. They are dealers in sharks' fins and fish maw. I know the Ki Hing Lau. I know the mistress Chan Chuen. I have known her in connection with the brothel several years. She has given us custom. Defendants owe me for sharks' fins as per bill produced, goods delivered at the brothel. I have not been paid. There is owing $541.27. I know the defendants—a brothel. I usually supply sharks' fins to brothels. Sharks' fins are used in brothels and in hotels. Brothels very often have sharks' fins. The large brothels must have them for their customers. This brothel came and dealt with us — in the brothel name. I supply quantities of fins to hotels and private persons. They are a common article of diet. I know no brothels that do not use them.'* The principal witness for the defendant said: *'You must have sharks' fins in a brothel or no one will patronise you. There are several tens of girls there.'* Gompertz J at trial gave judgment for Shun Loong Lee, and the defendant appealed.

Alabaster [counsel for the defendants]:

The Judgment of the learned judge was wrong. It has been abundantly proved that when the sharks' fins were supplied the plaintiff knew that they were for a brothel. It has also been abundantly proved that the fins supplied were to the knowledge of the plaintiff to be used for the purpose of attracting persons to the brothel. The fins were

14 *Pearce v Brooks* (1865-66) LR 1 Exch 213.

15 ibid at 217–218.

16 From a dishonourable cause an action does not arise.