

Contract Law in Hong Kong

A Comparative Analysis

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Hong Kong University Press
The University of Hong Kong
Pokfulam Road
Hong Kong
www.hkupress.org

© 2016 Hong Kong University Press

ISBN 978-988-8208-88-3 (*Hardback*)
ISBN 978-988-8208-89-0 (*Paperback*)

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British Library Cataloguing-in-Publication Data
A catalogue record for this book is available from the British Library.

10 9 8 7 6 5 4 3 2 1

Printed and bound by China Translation & Printing Services Ltd. in Hong Kong, China

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Preface

We hope that this work will provide readers with a clear understanding of contract law in Hong Kong, as well as its counterpart in England and Wales. Although this subject is technically demanding, the treatment is intended to be succinct and incisive.

The book is divided into thirteen chapters which are ordered to reflect teaching of contract law at both undergraduate and graduate levels. We have incorporated leading cases from Hong Kong, England and Wales, and other common law jurisdictions. There is a bibliography at the end of the book, but the footnotes in respective chapters also contain copious references to further literature.

The most recent edition of *Chitty on Contracts* (32nd edition, London, 2015) was not published in time for references to be made in this work.

This book has been designed to function equally well as a textbook for teaching or a reference work for practitioners and other interested parties, such as arbitrators, jurists, and business people.

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Cambridge, UK, and Hong Kong
July 2015

Chapter 1

Main Features of Contract Law in Hong Kong

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(1) Characteristics of Contract Law in Hong Kong

1.01 Contract law in Hong Kong is based on and still follows English contract law subject to legislation.¹ Like English contract law, it is organised into topics, as set out in the chapter headings of this work. These form the general part of the subject.² The general principles and doctrinal structure of English contract law emerged during the nineteenth century, as many have noted,³ as a result of both judicial and academic analysis. Hedley explains:⁴

¹ Articles 18 and 160 of the Basic Law of the Hong Kong Special Administrative Region; see also section 3 of the Application of English Law Ordinance (Cap 88).

² cf Roman law comprised a system of particular contracts: B Nicholas, *An Introduction to Roman Law* (OUP, 1962) 165ff.

³ P S Atiyah, *Essays on Contract* (OUP, 1986) 16ff; P S Atiyah, *The Rise and Fall of Freedom of Contract* (OUP, 1979) 681ff; S Hedley, 'Keeping Contract in Its Place—*Balfour v Balfour* and the Enforceability of Informal Agreements' (1985) 5 OJLS 391, 402; D Ibbetson, *A Historical Introduction to the Law of Obligations* (OUP, 1999) chs 5, 11, 12, and 13; M Lobban, in W Cornish and others, *The Oxford University Press History of the Laws of England, Vol XII, 1820–1914: Private Law* (OUP, 2010) 295ff; A W B Simpson, 'Innovation in Nineteenth-Century Contract Law' (1975) 91 LQR 247, at 250–57; W Swain, 'The Classical Model of Contract: The Product of a Revolution in Legal Thought?' (2010) 30 LS 513; W Swain, *The Law of Contract: 1670–1870* (CUP, 2015); S Waddams, *Principle and Policy in Contract Law: Competing or Complementary Concepts?* (CUP, 2011) ch 1, notably at 17ff.

⁴ S Hedley, 'Keeping Contract' (1985) 5 OJLS 391, 402.

the Victorians . . . were given a law of contracts, but turned it into a law of contract, with general principles applicable to all agreements. The responsibility for this development is largely that of Leake [1st edition, 1867], Pollock [1st edition, 1876] and Anson [1st edition, 1879], who each produced major textbooks expounding a law of contract and not merely collecting together rules on different types of contracts.

- 1.02** In modern times Parliament⁵ and judges⁶ have consistently assumed the existence of a coherent body of general rules applicable to all types of contracts as a whole (in *Geys v Société Générale, London Branch* (2012); Lord Wilson said that all contracts are at anchor ‘within the harbour which the Common Law has solidly constructed for the entire fleet of contracts’).⁷ In Hong Kong, the subject of contract law is organised in a similar fashion, distilling general rules and doctrines of ‘contract law’, and distinguishing this unifying body of law from the particular features of specific contracts, such as sale of goods, insurance, employment, etc.⁸
- 1.03** Contract law in Hong Kong is predominantly a case law subject. There are some statutes governing the general part of contract law. The main statutes affecting general contract law include:⁹ Sale of Goods Ordinance (Cap 26), Control of Exemption Clauses Ordinance (Cap 71), Unconscionable Contracts Ordinance (Cap 458), Third Parties (Rights Against Insurers) Ordinance (Cap 273), Supply of Services (Implied Terms) Ordinance (Cap 457), Misrepresentation Ordinance (Cap 284), Limitation Ordinance (Cap 347), Electronic Transactions Ordinance (Cap 553), and Civil Liability (Contribution) Ordinance (Cap 377).
- 1.04** In recent times, much collaborative energy has been spent identifying principles of contract acceptable to legal systems in general, whether common law, civilian or other. There are various ‘soft law codes’ (completed, subject to periodical revision, in draft, or merely contemplated), of which these are the most visible: (1) the global ‘commercial’ contract code, UNIDROIT’s *Principles of International Commercial Contracts* (2010);¹⁰ (2) ‘PECL’, ‘*Principles of European Contract*

⁵ eg, Misrepresentation Ordinance applies to all contracts and to deeds.

⁶ eg, Roskill LJ’s judgment in *The Hansa Nord* [1976] QB 44, 71 CA (general concept of ‘innominate term’ applicable to sale of goods transactions).

⁷ [2012] UKSC 63, [2013] 1 AC 523, at [97] (noted in D Cabrelli and R Zahn, ‘The Elective and Automatic Theories of Termination in the Common Law of the Contract of Employment: Conundrum Resolved?’ (2013) 76 MLR 1106–19).

⁸ M J Fisher and D G Greenwood, *Contract Law in Hong Kong* (expanded 2nd edn, Hong Kong UP, 2011); S Hall, *Law of Contract in Hong Kong: Cases and Commentary* (3rd edn, LexisNexis Butterworths, 2011); L Mason, *Contract Law in Hong Kong* (Sweet & Maxwell, 2011).

⁹ Generally, A Burrows, ‘The Relationship between Common Law and Statute in the Law of Obligations’ (2012) 128 LQR 232–59.

¹⁰ 3rd edn (2010), text and comment, is available at: <http://www.unidroit.org/english/principles/contracts/principles2010/integralversionprinciples2010-e.pdf>. M J Bonell has for many years been a leading force within the UNIDROIT organisation and has had a remarkable influence upon this influential work; see also his ‘Do We Need a Global Commercial Code?’ (2000–2003) Vol V, Rev dr unif (Uniform Law Rev) 469–81; M J Bonell (ed), *The UNIDROIT Principles in Practice: Case Law and Bibliography on the UNIDROIT Principles of International Commercial Contracts* (2nd edn, 2006). See also observations by M Furmston (2014) 31 JCL 61, 65–66.

Law', composed by the (Lando) Commission for European Contract Law;¹¹ (3) the 'ECC', the draft 'European Code of Contracts', composed by the Academy of European private law specialists, under the direction of Giuseppe Gandolfi; (4) 'DCFR', *Draft Common Frame of Reference*, prepared by the 'Study Group on a European Civil Code' and the 'Research Group on EC Private Law (Acquis Group)'; (5) a sales project for Europe.¹² Project (3) is in part a revision of project (2).¹³ Each project contains rules differing from the common law. None is binding in Hong Kong or any jurisdiction. However, the intellectual and 'transnational' weight of these remarkable projects cannot be ignored.

(2) The Objective Principle and 'Freedom of Contract'¹⁴

1.05 The objective principle of agreement is fundamental and pervasive: person's words or conduct must be interpreted in the manner in which the other party (or alleged party) might objectively and reasonably understand them.¹⁵ As Lord Reid said in *McCutcheon v David MacBrayne Ltd* (1964):¹⁶ 'the judicial task is not to discover the actual intentions of each party; it is to decide what each was reasonably entitled to conclude from the attitude of the other'. Thus, the objective principle concerns the following matters: is there an offer; has there been acceptance of that offer; if so on what terms; how should the terms of a written contract be interpreted; has the contract been varied or terminated by consensus; has a party repudiated the agreement, see '*The Pro Victor*' (2009);¹⁷ has the other

¹¹ O Lando and H Beale (eds), *Principles of European Contract Law* (Kluwer, 2000); H G Collins, *The European Civil Code: The Way Forward* (CUP, 2008).

¹² S Whittaker, 'The Proposed "Common European Sales Law": Legal Framework and the Agreement of the Parties' (2012) 75 MLR 578.

¹³ C von Bar and E Clive (eds), *Principles, Definitions and Model Rules of European Private Law Draft Common Frame of Reference (DCFR)* (6 volumes) (OUP/Sellier, 2010); H Eidenmuller et al., 'The Common Frame of Reference for European Private Law: Policy Choices and Codification Problems' (2008) 28 OJLS 659–708.

¹⁴ *Chitty on Contracts* (31st edn, Sweet & Maxwell, 2012) 1-028ff; P S Atiyah, *The Rise and Fall of Freedom of Contract* (OUP, 1979); S Smith, *Atiyah's Introduction to the Law of Contract* (6th edn, OUP, 2006) index at 432; R Brownsword, *Contract Law: Themes for the Twenty First Century* (2nd edn, OUP, 2006) ch 2; H G Collins, *The Law of Contract* (4th edn, CUP, 2003) index at 438; C Fried, *Contract as Promise: A Theory of Contractual Obligation* (Harvard UP, 1981); J Gordley, *The Philosophical Origins of Modern Contract Doctrine* (OUP, 1991); D Kimel, *From Promise to Contract* (Hart, 2005) ch 5; D Ibbetson, *A Historical Introduction to the Law of Obligations* (OUP, 1999) chs 7, 11, 12, 13; S A Smith, *Contract Theory* (OUP, 2004) index at 448.

¹⁵ McLaughlan has lucidly distinguished (although this distinction has a long lineage) (1) the 'promise'-based form of objectivity from (2) the 'detached observer' or 'fly-on-the-wall' form of objectivity. The preferred form is (1). The passage from McLaughlan, too long to quote here, merits close attention: D McLaughlan, 'Refining Rectification' (2014) 130 LQR 83, at 88–90. See also: D Friedmann (2003) 119 LQR 68; J R Spencer, 'Signature, Consent, and the Rule in *L'Estrange v Graucob*' [1973] CLJ 104; W Howarth, 'The Meaning of Objectivity in Contract' (1984) 100 LQR 265; J Vorster, 'A Comment on the Meaning of Objectivity in Contract' (1987) 103 LQR 274; M Chen-Wishart, in J W Neyers, R Bronaugh, and S G A Pitel (eds), *Exploring Contract Law* (OUP, 2009) 341ff.

¹⁶ [1964] 1 WLR 125, HL; see also *Shogun Finance Co Ltd v Hudson* [2003] UKHL 62; [2004] 1 AC 919, HL, at [183].

¹⁷ *SK Shipping (S) PTE Ltd v Petroexport Ltd ('The Pro Victor')* [2009] EWHC 2974, Flaux J at [89]–[98].

party accepted that repudiation; has a voidable contract been ‘affirmed’ by a party; is there an intent to create legal relations (*per* Aikens LJ in *Barbudev v Eurocom Cable Management Bulgaria Eood* (2012)¹⁸ and *Attrill v Dresdner Kleinwort Ltd* (2013)?¹⁹

The principle of ‘freedom of contract’ is recognised both in Hong Kong law and in other legal traditions.²⁰ It permits parties to conclude agreements on a wide range of matters and on such terms as they wish. The classic statement (made in response to an unsuccessful plea that a contract was contrary to public policy) is by Sir George Jessel in *Printing & Numerical Registering Co v Sampson* (1875):²¹

if there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice. Therefore, you have this paramount public policy to consider—that you are not lightly to interfere with this freedom of contract.

The principle embraces the following liberties. First, parties have a general freedom to enter into transactions which they intend (explicitly or otherwise) should impose legal obligations.²² This freedom includes the power to formulate individual terms within such a transaction, or to acquiesce in ‘default’ terms ‘implied’ by statute or common law. Secondly, parties to a transaction can stipulate that it will not be legally binding. Thirdly, freedom to contract includes the liberty to compromise a legal dispute, or to waive legal liability. But a contract of compromise must be very clearly worded if it is to extend to one party’s prospective liability towards the other, that is, liability which has not yet arisen but which might arise in the future if there were to be a change in the law.²³ Exercise of these interrelated freedoms is subject to the overarching limitations of (i) public policy (chapter 13);²⁴ (ii) the parties’ inability to exclude liability for fraud at common law;²⁵ (iii) statutory regulation of adhesion clauses (8.43ff); (iv) personal capacity: if one party’s insanity is not known to the other party, *Hart v O’Connor* (1985)

¹⁸ [2012] EWCA Civ 548; [2012] 2 All ER (Comm) 963, at [30]: ‘On the issue of whether the parties intended to create legal relations . . . [the] court has to consider the objective conduct of the parties as a whole.’

¹⁹ [2013] EWCA Civ 394; [2013] 3 All ER 807 at [61], [62], [86], [87] *per* Elias LJ.

²⁰ *eg*, comments in M J Bonell (ed), *The UNIDROIT Principles in Practice: Case Law and Bibliography on the UNIDROIT Principles of International Commercial Contracts* (2nd edn, Ardsley, 2006) 69.

²¹ (1875) LR 19 Eq 462, 465 (heard at first instance).

²² *eg*, contractual estoppel, including estoppel by deed, enables the parties to establish agreed facts, even though they know them to be untrue, if this is not inconsistent with public policy, *Prime Sight Ltd v Lavarello* [2013] UKPC 22; [2014] AC 436, at [47], *per* Lord Toulson.

²³ *BCCI v Ali* [2001] UKHL 8; [2002] 1 AC 251 [19], [21], [35], [86]; *cf* the dissent at [73] by Lord Hoffmann; N Andrews, *English Civil Procedure* (OUP, 2003) 23.65–23.77.

²⁴ *Chitty on Contracts* (31st edn, Sweet & Maxwell, 2012) ch 16; G H Treitel, *The Law of Contract*, edited by E Peel (13th edn, Sweet & Maxwell, 2011) ch 11.

²⁵ *S Pearson & Son Ltd v Dublin Corp* [1907] AC 351, 353, 362, HL; *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] 2 Lloyd’s Rep 61, HL, at [16] *per* Lord Bingham, [98] *per* Lord Hobhouse; noted in K R Handley ‘Exclusion Clauses for Fraud’ (2003) 119 LQR 537.

makes clear that a contract will arise (for qualifications, see the next paragraph);²⁶ as for persons under 18, so-called ‘minors’, for reasons of space the law on this topic can only be sketched in this note;²⁷ as for ‘legal persons’, the company must be validly formed.

*Mental Disability or Insanity generally:*²⁸ Here there are two regimes, the scope of the second being subject to the first. The first regime concerns compromises or settlements of pending or contemplated civil proceedings. Here failure to comply with the paternalistic system of representation and judicial supervision will render the resulting agreement void, whether or not the other party was aware of the protected party’s mental incapacity. The court supervises settlement and compromises of claims which affect the interests of children (those under 18) and mentally disordered or handicapped persons, within the meaning of the Mental Health Ordinance (Cap 136), whether those claims are brought on behalf of those persons or against them.²⁹ The basic rule is that no settlement, compromise or payment and no acceptance of any money paid into court concerning (that is, a claim by, or on behalf of, or against) a minor or a mentally disordered person is valid without the court’s approval.³⁰

The Supreme Court of the United Kingdom in *Dunhill v Burgin (Nos 1 and 2)* (2014) held that a consent agreement reached without awareness that a party is in fact suffering from a disability (in this case, lack of mental capacity) can be set aside for failure to comply with the present procedure for judicial ratification.³¹

²⁶ *Hart v O’Connor* [1985] 2 All ER 880, PC (the ‘rule in *Imperial Loan Co v Stone* [1892] 1 QB 599’, see *Blankley v Central Manchester and Manchester Children’s University Hospitals NHS Trust* [2014] EWHC 168; [2014] 1 WLR 2683, at [30], *per* Phillips J); however, where the incapax’s property is subject to the control of the court, under sections 15ff of the Mental Capacity Act (UK) 2005, transactions which would be inconsistent with the court’s control of those assets will be void as against that party; *Chitty on Contracts* (31st edn, Sweet & Maxwell, 2012) 8-074, and G H Treitel, *The Law of Contract*, edited by E Peel (13th edn, Sweet & Maxwell, 2011) 12-056, 12-057.

²⁷ *Chitty* (31st edn, Sweet & Maxwell, 2012) 8-002ff (see also S Hedley, ‘Implied Contract and Restitution’ (2004) CLJ 435, 440–42); (i) a minor is liable for ‘necessaries’ purchased: section 4, Sale of Goods Ordinance (Cap 26); *Nash v Inman* [1908] 2 KB 1, CA; ‘necessaries’ can include certain services (*Chitty*, *ibid.*, 8-013); (ii) a minor is bound by a contract of employment or apprenticeship as long as it is on the whole beneficial to him; but this does not extend to a contract to promote the prospects of a talented footballer, *Proform Sports Management Ltd v Proactive Sports Management Ltd* [2006] EWHC 2903 (Ch); [2007] 1 All ER 542 (the ‘Wayne Rooney’ case); (iii) contracts for the sale or purchase of land, or the grant or acquisition of a lease, or for the onerous acquisition of shares, can be repudiated by a minor or, after he reaches 18, repudiated within a reasonable time (on the problematic grant of a lease to a minor, *Hammersmith & Fulham LBC v Alexander-David* [2009] EWCA Civ 259; [2009] 3 All ER 1098); (iv) all other types of contract (eg, a contract of insurance or a trading contract, or a contract for a luxury item not within the scope of ‘necessaries’, are not binding on the minor unless he ratifies the transaction after reaching 18, *Chitty*, *ibid.*, 8-043ff; (v) section 4, Age of Majority (related provisions) Ordinance (Cap 410) permits the court to order restitution of ‘any property acquired by the [minor] under the contract, or any property representing it’, even if the minor has not lied about his age, and this provision applies to all contracts other than those at (i) and (ii).

²⁸ G Spark, *Vitiating of Contracts* (CUP, 2013) ch 2, 53–61.

²⁹ Hong Kong Rules of the High Court (RHC) Order 80.10.

³⁰ RHC O.80.10.

³¹ [2014] UKSC 18; [2014] 1 WLR 933.

The procedure is examined in detail in the leading specialist work.³² This paternalistic rule is not confined to proposed settlements reached after commencement of formal proceedings. And so, when a minor or protected party (a person lacking capacity under the Mental Capacity Act (UK) 2005 is called a ‘protected party’) reaches an agreement to settle a claim (or on whose behalf such a settlement is reached) before proceedings are begun, the court’s approval must be obtained.³³ This requires an application under the English CPR Part 8. Litigation concerning minors or protected parties must be conducted by a litigation friend, unless (but only in the case of minors who are not also protected parties) the court dispenses with this.³⁴

(3) Contract and Tort Law³⁵

1.06 In some situations, the relationship underlying the agreement simultaneously involves a common law or extra-contractual duty to exercise reasonable care (**11.02** and **12.31**). There can then be overlapping rights and duties in contract and in tort. This is true of many professional relationships. The House of Lords affirmed in *Henderson v Merrett Syndicates Ltd* (1995)³⁶ that when a contractual duty of care overlaps with an essentially similar duty of care imposed by the tort of negligence, a claimant can select whichever cause of action he prefers, or indeed he can plead both. The main difference between these ‘concurrent’ sources of claim (‘causes of action’) is the calculation of the limitation period: ‘in cases of breach of contract the cause of action arises at the date of the breach of contract’; however, ‘in tort the cause of action arises, not when the culpable conduct occurs, but when the plaintiff first sustains damage’.³⁷ The limitation periods for breach of contract are six years for ordinary (‘simple’)³⁸ contracts (oral, written, and partly written contracts, other than deeds or covenants) and twelve years for deeds.³⁹

(4) Contract and Restitution or Unjust Enrichment⁴⁰

1.07 Contract law often interacts with the law of restitution, a category of obligations now recognised to subsist separately from contract and tort.⁴¹ Restitutionary claims are based on the defendant’s unjust enrichment. Most restitutionary remedies become

³² D Foskett, *The Law and Practice of Compromise* (7th edn, Sweet & Maxwell, 2010) ch 27, and noting the impact of the Mental Capacity Act (UK) 2005, which took effect on 1 October 2007.

³³ English CPR 21.10(2).

³⁴ English CPR 21.2.

³⁵ A S Burrows, *Understanding the Law of Obligations* (Hart, 1998) chs 1, 2, 8.

³⁶ [1995] 2 AC 145, HL.

³⁷ *Nykredit Mortgage Bank plc v Edward Erdman Group Ltd (No 2)* [1997] 1 WLR 1627, 1630, HL.

³⁸ Section 4(1)(a), Limitation Ordinance (Cap 347).

³⁹ Section 4(3), Limitation Ordinance (Cap 347) refers to actions on ‘specialties’, for example, a deed.

⁴⁰ Leading works include: T Baloch, *Unjust Enrichment and Contract* (Hart, 2009); A S Burrows, *The Law of Restitution* (3rd edn, OUP, 2011); A S Burrows, *A Restatement of the English Law of Unjust Enrichment* (OUP, 2012); *Goff and Jones on the Law of Unjust Enrichment* (8th edn, Sweet & Maxwell, 2011); G Virgo, *The Principles of the Law of Restitution* (2nd edn, OUP, 2006); A S Burrows, E McKendrick, and J Edelman, *Cases and Materials on the Law of Restitution* (2nd edn, OUP, 2007).

⁴¹ A S Burrows, *Understanding the Law of Obligations* (Hart, 1998) chs 1, 3.

available without the need to show a contractual breach. However, breach of contract is an essential element in one restitutionary remedy: the remedy of ‘equitable account’ (see the *Attorney-General v Blake*⁴² line of cases, 12.48ff). A restitutionary claim is not made to remedy a claimant’s loss. Instead, it is a claim in respect of the defendant’s enrichment at the claimant’s expense (for example, if the claimant has transferred money to, or conferred the benefit of services upon, the defendant). Thus, the enrichment can be money or services or goods. The cause of action based on restitution or unjust enrichment can take various forms: it might be that the benefit was conferred as a result of the claimant’s mistake of fact or law; or that there was a (total) failure of consideration, or duress, or undue influence, or abuse of fiduciary relationship,⁴³ or an unjustified tax demand. There are three main forms of restitutionary relief relevant to contract law: (i) money recovered for a total failure of consideration; (ii) recovery in respect of goods or services; (iii) disgorgement of gains made in breach of contract.

(5) Common Law and Equity

1.08 The distinction between common law and equity remains important for the exposition of contract law. Thus in the modern law, there is still a fundamental distinction between common law and *equitable* doctrines⁴⁴ and remedies. Examples of this classification are: the equitable doctrines of rectification (9.22), undue influence, unconscionability (on these see chapter 7), and equitable bars upon rescission (6.22); and the common law doctrines of ‘mistake’ or duress (on these see chapters 6 and 7). As for remedies for breach of contract (see chapter 12), the money claims for debt and damages are both common law remedies; but injunctions, specific performance and an account of profits, are ‘equitable’. Some recent decisions have tended to diminish the common law/equitable distinction.⁴⁵

1.09 The distinction between common law and equity remains ‘bed-rock’ within English private law, and in other common law jurisdictions, including Hong Kong. It will prove hard to eradicate. However, a debate has emerged whether English law should ‘move on’ and jettison this historical baggage. Andrew Burrows has strongly advocated abandonment of this distinction.⁴⁶ But it is likely that this distinction will endure for many years, and that even a codification of contract law

⁴² [2001] 1 AC 268 HL; J Edelman, *Gain-Based Damages* (Hart, 2002) ch 5; E McKendrick in Burrows and Peel (eds), *Commercial Remedies: Current Issues and Problems* (OUP, 2003) 93–119; A S Burrows, *Remedies for Torts and Breach of Contract* (3rd edn, OUP, 2004) 395–407.

⁴³ For a convenient summary, *Calvert v William Hill Credit Ltd* [2008] EWCA Civ 1427; [2009] Ch 330, at [53].

⁴⁴ In the USA, the fact that the remedy of injunction is ‘equitable’ places a claim for such relief outside the constitutional guarantee of jury trial: see G Hazard and M Taruffo, *American Civil Procedure* (Yale UP, 1993) 130.

⁴⁵ eg, no separate doctrine of shared ‘equitable’ mistake, *The Great Peace* [2003] QB 679, CA; no separate equitable principles of construction of contracts, *BCCI v Ali* [2001] UKHL 8; [2002] 1 AC 251, at [17].

⁴⁶ Inaugural Oxford University Press lecture, A S Burrows, ‘We Do This at Common Law but That in Equity’ (2002) 22 OJLS 1.

would merely echo the fundamental conceptual distinctions between common law and equity.

(6) Good Faith

- 1.10** This topic has produced a vast literature.⁴⁷ This concept applies potentially both to performance of contracts and to the pre-contractual phase. ‘Good faith’ is a prominent feature of civil law systems of contract law: see § 242, BGB in Germany; Article 1134 French Civil Code; Articles 1337, 1366, 1375, Italian Civil Code. The same concept has been adopted in the USA, both in the *Restatement on Contracts* (2nd edn, 1981, § 205) and the *Uniform Commercial Code* (§ 1–203). It also plays a significant role in the *Contract Law of the People’s Republic of China (PRC)* (Article 6, 1999).⁴⁸ Furthermore, UNIDROIT’s *Principles of International Commercial Contracts* (2010), Article 1.7,⁴⁹ PECL, Article 2:201, and the *Draft Common Frame of Reference*, Article III-1:103,⁵⁰ all adopt this principle.
- 1.11** But ‘good faith’ is not an explicitly recognised general doctrine in English contract law. As Bingham LJ said in *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* (1989):⁵¹ ‘English law has, characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated problems of unfairness.’
- 1.12** The authors’ contentions are: (i) in Hong Kong the principle of good faith is not required in the context of *pre-contractual negotiations* because of the highly developed and fertile array of existing doctrines; but (ii) as for ‘good faith’ as a general principle governing *performance of contracts*, the case is more evenly balanced. In the case of (ii), there would be only a slight benefit in making such

⁴⁷ J Beatson and D Friedmann (eds), *Good Faith and Fault in Contract Law* (OUP, 1995) chs 2 (N Cohen, Israel), 6 (E A Farnsworth, USA), and 7 (W Ebke and B M Steinhauer, Germany); A Berg, ‘Promises to Negotiate in Good Faith’ (2003) 119 LQR 357; R Brownsword, *Contract Law: Themes for the Twenty First Century* (2nd edn, OUP, 2006) ch 5 (also in R Brownsword in M Furmston (ed), *The Law of Contract* (3rd edn, London, 2007) ch 1; S Burton and E Andersen, *Contractual Good Faith* (Little Brown, 1995); M Clarke, ‘The Common Law of Contract in 1993: Is There a General Doctrine of Good Faith?’ (1993) 23 HKLJ 318; H G Collins, ‘Good Faith in European Contract Law’ (1994) 14 OJLS 229; H G Collins, *The Law of Contract* (4th edn, CUP, 2003) chs 10, 15; A Forte (ed), *Good Faith in Contract and Property Law* (Hart, 1999); E McKendrick, *Contract Law: Text, Cases and Materials* (6th edn, OUP, 2014) ch 15; J O’Connor, *Good Faith in English Law* (Aldershot, 1990) ch 3; (Lord) Steyn, ‘Contract Law: Fulfilling the Reasonable Expectations of Honest Men’ (1997) 113 LQR 433; G Teubner, ‘Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences’ (1998) 61 MLR 11; R Zimmermann and S Whittaker (eds), *Good Faith in European Contract Law* (CUP, 2000) (reviewed, N Andrews (2001) CJQ 197); H MacQueen and R Zimmermann (eds), *European Contract Law: Scots and South African Perspectives* (Edinburgh, 2006) 17–18 (Zimmermann), and ch 2 (MacQueen).

⁴⁸ F Yang, *Contracts for the International Sale of Goods in China* (Wolters Kluwer Law and Business and CCH Hong Kong, 2012) ch 3.

⁴⁹ 3rd edn (2010), text and comment, is available at: <http://www.unidroit.org/english/principles/contracts/principles2010/integralversionprinciples2010-e.pdf>

⁵⁰ C von Bar and E Clive (eds), *Principles, Definitions and Model Rules of European Private Law Draft Common Frame of Reference* (6 vols, OUP/Sellier, 2010).

⁵¹ [1989] QB 433, 439, CA.

a change. The courts would be unlikely to use the concept dynamically. The inevitable anxiety and uncertainty experienced within the legal profession, when advising their clients, might outweigh the possible and marginal benefits of such a change. But as the ensuing discussion briefly notes, there is a case for an incremental use of an implied term of ‘fair dealing’ within contracts importing mutual expectations of commercial trust.

- 1.13** It is submitted that the selective and fact-sensitive technique of implying terms enables the English courts to do justice in a free and generous fashion guided by the criteria of commercial necessity and basic understanding of minimum levels of fair dealing. As we saw at **8.17ff**, the implied term technique is also precise (prescribing rules for specific types of transactions, ‘terms implied in law’, or even recognising ‘one-off’ ‘terms implied in fact’).

Consistent with this, an interesting straw in the wind is the suggestion made by Leggatt J, in *dicta* in *Yam Seng Pte Ltd v International Trade Corp Ltd* (2013), that the courts should adopt a more energetic use of an implied term of good faith, going further than avoidance of lying⁵² and importing a duty of ‘fair dealing’, notably within so-called ‘relational’ contracts requiring mutual trust between parties (see below). The present case concerned a distributorship agreement of almost three years duration.

Leggatt J’s judgment notes the factors which have impeded recognition of a general implied term of good faith.⁵³ But he comments that the English ‘jurisdiction would appear to be swimming against the tide’, citing the wider contexts of European law, American, and Commonwealth tendencies.⁵⁴ He also notes the process of construing written contract by having regard to ‘shared values and norms of behaviour’,⁵⁵ notably the duty to avoid dishonesty,⁵⁶ but (at least in some contexts and in a restricted sense) the duty to avoid conduct which would stultify the contract.⁵⁷

⁵² [2013] EWHC 111 (QB); [2013] 1 All ER (Comm) 1321; [2013] 1 Lloyd’s Rep 526; [2013] BLR 147 (notably at [141], [144], [147], and [154]); noted by S Bogle, ‘Disclosing Good Faith in English Contract Law’ (2014) 18 Edin LR 141–45; D Campbell, ‘Good Faith and the Ubiquity of the “Relational” Contract’ (2014) 77 MLR 475–92; S Whittaker, ‘Good Faith, Implied Terms and Commercial Contracts’ (2013) 129 LQR 463; E Granger [2013] LMCLQ 418; more generally, H Hoskins, ‘Contractual Obligations to Negotiate in Good Faith: Faithfulness to the Agreed Common Purpose’ (2014) 130 LQR 131–59. See also the *dicta* in *Berkeley Community Villages Ltd v Pullen* [2007] EWHC 1330; [2007] NPC 71, at [141], *per* Morgan J.

⁵³ *ibid*, at [123], referring to the incremental technique; the tradition of individualism; and uncertainty.

⁵⁴ *ibid*, at [124]–[130], referring to the incremental technique; the tradition of individualism; and uncertainty.

⁵⁵ *ibid*, at [134].

⁵⁶ *ibid*, at [135] and [136], citing, in particular, Lord Hoffmann’s statement in *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] 2 Lloyd’s Rep 61, HL, at [68], ‘in the absence of words which expressly refer to dishonesty, it goes without saying that underlying the contractual arrangements of the parties there will be a common assumption that the persons involved will behave honestly.’

⁵⁷ *Yam Seng* case, *ibid*, at [139], citing ‘the body of cases in which terms requiring cooperation in the performance of the contract have been implied: see *Mackay v Dick* (1881) 6 App Cas 251, 263, HL.

In particular, he referred to ‘relational’⁵⁸ contracts which ‘require a high degree of communication, cooperation and predictable performance based on mutual trust and confidence and involve expectations of loyalty which are . . . implicit . . . and necessary to give business efficacy to the arrangements’.⁵⁹ And he said: ‘examples of such relational contracts might include some joint venture agreements, franchise agreements and long term distributorship agreements.’⁶⁰ Implied terms can be found on a case-by-case basis: ‘the content of the duty is heavily dependent on context and is established through a process of construction of the contract, its recognition is entirely consistent with the case by case approach favoured by the common law.’⁶¹ And he suggested that the nomenclature of ‘fair dealing’ should be preferred to the ‘red flag’ of ‘good faith’.⁶² To dispel any fear of a runaway new concept, in *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (Trading as Medirest)* (2013) Beatson LJ (an authority on contract law, former law commissioner, and former professor of law in Cambridge) has attractively emphasised the incremental, objective, and commercial character of the implied term of fair dealing.⁶³

(7) The Codification Question

1.14 *Benefits of a Code:*⁶⁴ A code is composed of a set of legislative provisions. It is normally quite systematic and relatively succinct (although the text might be amplified by comments and illustrations, as in the case of the American Law Institute’s Restatements). A code would be up-to-date, however fleetingly, and accessible, even portable⁶⁵ (of course, in the age of computer retrieval systems and memory sticks, physical weight has become no real problem; instead, the problem is the ‘tsunami’ of electronic information). Code drafters can start with clean

⁵⁸ On ‘relational contracts’, see the essays in D Campbell, L Mulcahy, and S Wheeler (eds), *Changing Concepts of Contract* (Palgrave, 2013), notably ch 6 by H Beale.

⁵⁹ *Yam Seng* case [2013] EWHC 111 (QB); [2013] 1 All ER (Comm) 1321; [2013] 1 Lloyd’s Rep 526; [2013] BLR 147, at [142].

⁶⁰ *ibid*, at [142].

⁶¹ *ibid*, at [147].

⁶² *ibid*, at [150].

⁶³ [2013] EWCA Civ 200; [2013] BLR 265; [2013] CILL 3342, at [150].

⁶⁴ M Arden, ‘Time for an English Commercial Code’ [1997] CLJ 516; R Goode, ‘Removing the Obstacles to Commercial Law Reform’ (2007) 123 LQR 602–17; Lord Falconer, ‘Opening Speech’ (European Contract Law Conference, London, 26 September 2005), <http://www.dca.gov.uk/speeches/2005/lc150905.htm>; E Hondius, *Towards a European Civil Code* (3rd edn, 2004); H Kronke (2005) *Loyola Law Review* 287–99; O Lando, ‘Principles of European Contract Law and UNIDROIT Principles: Similarities, Differences and Perspectives’ (Centro di studi e ricerche di diritto comparata e straniero, Roma, 2002); Lord Mance, ‘Is Europe Aiming to Civilise the Common Law?’ (Chancery Bar Lecture, Lincoln’s Inn, 27 March 2006); A Tettenborn, ‘Codifying Contracts—An Idea Whose Time Has Come?’ (2014) 67 CLP 273; S Vogenauer (ed), *The Harmonisation of European Contract Law* (Hart, 2005); Clifford Chance Survey on European Contract Law (Clifford Chance publications, April 2005); ‘European Contract Law, the Way Forward?’, House of Lords Select Committee E (EU committee), HL Paper 95 (2005), <http://www.publications.parliament.uk/pa/ld200405/ldselect/ldcom/95/9502.htm>. A recent codification of the common law rules of contract is available at: http://www.difc.ae/laws_regulations/laws/enacted_laws.html (Dubai International Financial Centre).

⁶⁵ cf this practical problem in nineteenth-century colonial administration: Indian Contract Act 1872.

sheets of paper and produce a pleasingly coherent set of provisions: delineating categories, subcategories, rules, and sub-rules, and identifying overarching principles. The first author, Neil Andrews, has participated in this process, in Rome, in the field of civil procedure: the American Law Institute/UNIDROIT's *Principles of Transnational Civil Procedure* (2000 to 2004):⁶⁶ on which he commented in 2009.⁶⁷

- 1.15** *Problems with the Case Law Technique:* The system of common law decision-making is haphazard. It depends on the adventitious selection by claimants and appellants of disputes and issues to be litigated and taken on appeal. And so the true rule can remain uncertain—at least at its edges—for many years, even for decades. Furthermore, common law decisions are long and difficult to unravel. The process of working out the substance of the rule is a time-consuming, skilled and specialist craft, and the answers are not always rock-solid.
- 1.16** *Attempts at Codifying the Common Law System of Contract Law:* There have been at least three attempts, two of which have come to fruition. First, the Indian Contract Act 1872, a codification of the common law's general principles of contract law, continues to apply in the Indian subcontinent. In fact, this legislation crossed the Indian Ocean and was adopted in some of the former British colonies in East Africa. Secondly, the Scottish and English Law Commissions combined to produce a draft contract code in the 1960s. Treitel, the greatest living contract scholar in the UK, was heavily involved. However, the Scots pulled out, and the English project was eventually abandoned. The draft was published much later, but only in Italy.⁶⁸ The foreign place of publication is significant: the modern codification project was sent into exile.⁶⁹ Thirdly, the Dubai International Financial Centre has produced a codification of English contract law, for use in arbitration or other litigation conducted in Dubai.⁷⁰ This is not 'English law', but rather English law as refined, modified, and codified by the advisors to the Dubai authorities (the advisors and draftsmen were English experts). However, both in form and content, this twenty-first-century foreign code might portend the future in England.
- 1.17** *Reluctance to Abandon the Case Law Tradition in England:* Some influential English judges and jurists are hostile to the notion of codifying contract law. This attitude cannot be dismissed as mere complacency, or conservatism. It might be contended that there are three reasons for preserving the common law case law method in the field of contract. First, the current law works tolerably well, so why try to fix it? England is a single, unified jurisdiction. One can contrast the United States of America, where there are many State jurisdictions within a

⁶⁶ Accessible at: <http://www.unidroit.org/english/principles/civilprocedure/main.htm>. Also published as *ALI/UNIDROIT: Principles of Transnational Civil Procedure* (CUP, 2006).

⁶⁷ N Andrews, 'The Modern Procedural Synthesis: The American Law Institute and UNIDROIT's "Principles and Rules of Transnational Civil Procedure"' (2008) 164 *Revista de Processo* 109 (Brazil), also published in (2009) *Tijdschrift voor Civiele Rechtspleging* 52 (Netherlands).

⁶⁸ Harvey McGregor QC, *Contract Code: Drawn up on Behalf of the English Law Commission* (Giuffrè Editore, Milano, 1993).

⁶⁹ This recent codification of the common law rules of contract is available at: http://www.difc.ae/laws_regulations/laws/enacted_laws.html (Dubai International Financial Centre).

⁷⁰ http://www.difc.ae/laws_regulations/index.htmlDIFC.

Federal entity. Americans receive nationwide guidance from the ‘Restatement of Contracts’ and the ‘Uniform Commercial Code’. Secondly, the pragmatic strength of English contract law derives from its having been refined in response to real cases. It is not abstract and over-intellectual doctrine. Instead, the common law consists of propositions ‘hammered out on the anvil’ of adversarial debate in the courtroom.⁷¹ Finally, proof of the law’s attractiveness is that English contract law is often chosen by ‘transnational’ contracting parties as the applicable law.⁷² Negotiation of commercial contracts and resolution of disputes arising from them are big international business. London lawyers take a good slice of that work.⁷³

- 1.18** *Enhancing Hong Kong Law’s Accessibility*: Perhaps pressure to produce a blending of common law and various civil law traditions might one day prove irresistible. There is little evidence, however, whether within Hong Kong SAR there is imminent wish to abandon the contract rules of the common law in favour of a code or not.
- 1.19** However, it would be attractive to compose a purely Hong Kong contract code, not binding on anyone unless the parties ‘contract to apply it’. It would thus be capable of being chosen as the applicable law by parties, notably by those engaged in cross-border commerce. Parties could explicitly adopt the contract code by using appropriately worded ‘choice of law’ clauses (8.10). The contract code could be frequently updated. Commentaries might link the contract code with case law developments and pre-existing case law. In this way, litigant from other jurisdictions would find it possible to ‘look up’ a point of Hong Kong contract law. This would surely enhance Hong Kong law’s position in the global marketplace. If the experiment were to prove successful, perhaps contract law based on the English common law of contract would eventually be superseded by legislation.

(8) European Union Law

- 1.20** Hong Kong law is not subject to the various EU Directives or Regulations, nor has it been able to benefit from the further development of English law under the influence of EU law. The most important examples of British enactment of such European measures are the Consumer Rights Act (UK) 2015⁷⁴ and the Consumer Contracts (Information, Cancellation and Additional Charges) Regulations (2013).⁷⁵

⁷¹ cf Lord Steyn in *Attorney-General v Blake* [2001] 1 AC 268, 291, HL: ‘Exceptions to the general principle that there is no remedy for disgorgement of profits against a contract breaker are best hammered out on the anvil of concrete cases.’

⁷² N Andrews, *English Civil Justice: Progress and Remedies: Nagoya Lectures* (Shinzan Sha Publishers, Tokyo, 2007) 3-06.

⁷³ R Aikens, ‘With a View to Despatch’, in M Andenas and D Fairgrieve, *Tom Bingham and the Transformation of the Law: A Liber Amicorum* (OUP, 2009) 563–88, commenting on the need to maintain the attractiveness of the English Commercial Court and of English commercial law.

⁷⁴ The Explanatory Notes, although highly detailed, are helpful (<http://www.publications.parliament.uk/pa/bills/cbill/2013-2014/0161/en/14161en.htm>); see also the summary available within this document: <http://www.parliament.uk/business/publications/research/briefing-papers/LLN-2014-023/consumer-rights-bill-hl-bill-29-of-201415>.

⁷⁵ Consumer Contracts (Information, Cancellation and Additional Charges) Regulations 2013/3134.

(9) Harmonisation of Contract Law in the Greater China Region

- 1.21** Over the past decade, a new framework for trade and investment between the territorial units of the People's Republic of China (the PRC) has emerged. These territorial units comprise the Mainland of China (the Mainland); the Hong Kong Special Administrative Region (Hong Kong),⁷⁶ returned to China by the United Kingdom in 1997; the Macao Special Administrative Region (Macao),⁷⁷ returned to China by Portugal in 1999; and the Republic of China (Taiwan),⁷⁸ whose political and legal status remains contentious despite its improving relationship with the PRC. Trade and investment between the Mainland, Taiwan, Hong Kong, and Macao have become very significant and will continue to grow. There is a need for a uniform or harmonised commercial law framework, in particular, a harmonised contract law for the Greater China Region.⁷⁹
- 1.22** For this reason, Hong Kong lawyers should keep an open mind to the possibility of: improving substantive law; rendering it still more up-to-date and predictable; jettisoning some of its doctrinal baggage; re-examining some of its rigidities; refining some of its rules; and taking advantage of other legal systems' good ideas. The authors' modest suggestion, therefore, is that the Hong Kong Commercial Bar, or perhaps the Department of Justice, should commission lawyers and experts to produce a contract code and to exert influences on the further development of contract law by participating in the harmonisation of contract law in the region. The second author, Fan Yang, has participated in the process of drafting a model contract law for the Greater China Region, a nationwide project led by the China Law Society's Civil Law Institute (中國民法學研究會), and Renmin University's Centre of Civil and Commercial Law (中國人民大學民商事法律科學研究中心) in China.

⁷⁶ The Mainland and Hong Kong signed the main text of CEPA on 29 June 2003 and its six annexes on 29 September 2003. Pursuant to Article 3 of CEPA, which provides that the two sides will broaden and enrich the content of the Arrangement through continuous and further reciprocal liberalisation, the two sides signed nine Supplements to CEPA on 27 October 2004, 18 October 2005, 27 June 2006, 29 June 2007, 29 July 2008, 9 May 2009, 27 May 2010, 13 December 2011, and 29 June 2012, respectively, available at: http://www.tid.gov.hk/english/cepa/legaltext/cepa_legaltext.html.

⁷⁷ The Mainland and Macao Closer Economic Partnership Arrangement (CEPA) Main Text and Six Annexes were signed on 17 October 2003. The Supplement II to IX to CEPA were signed on 29 October 2004, 21 October 2005, 26 June 2006, 2 July 2007, 30 July 2008, 11 May 2009, 28 May 2010, 14 December 2011, and 2 July 2012, respectively, available at: http://www.economia.gov.mo/web/DSE/public/?_nfpb=true&_pageLabel=Pg_EETR_CEPA_S&locale=en_US.

⁷⁸ The Mainland and Taiwan Economic Cooperation Framework Agreement (ECFA) was signed on 29 June 2010.

⁷⁹ For a discussion on the harmonisation of sale of goods contract law in the region, see Fan Yang, 'A Uniform Sales Law for the Mainland China, Hong Kong SAR, Macao SAR and Taiwan—The CISG' (2011) *The Vindobona J of Intl Commercial Law and Arbitration* 15(2) 345–64; and Fan Yang, *Contracts for the International Sale of Goods in China* (CCH Hong Kong, 2012) 131–56.

Chapter 13

Illegality and Public Policy

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(1) Introduction¹

13.01 In the UK, the Law Commission has acknowledged (with understatement) in its report, ‘The Illegality Defence’ (2010), that the law of illegality in contract law is ‘an intricate web of tangled rules that are difficult to ascertain and distinguish’. As the UK Law Commission had stated in its 1999 Consultation Paper,² legislation has not been recommended, other than in the context of illegality affecting proprietary interests under trusts law.³ Instead, in the field of contract law, the UK Law Commission in 2009 expressed the hope that the courts will develop a clearer statement of ‘the policies that underlie the illegality defence’ and allow that defence ‘to succeed only . . . where it has some merit’.⁴

¹ *Chitty on Contracts* (31st edn, Sweet & Maxwell, 2012) ch 16; R A Buckley, *Illegality and Public Policy* (3rd edn, Sweet & Maxwell, 2013); N Enonchong, *Illegal Transactions* (Sweet & Maxwell, 1998); for a wider perspective, M J Trebilcock, *The Limits of Freedom of Contract* (Harvard UP, 1997).

² ‘The Illegality Defence’ (L Com CP No 189: 2009) 1.14, 3.122.

³ On which see the recommendations in ‘The Illegality Defence’ (No 320: 2010): this need for legislation is the ‘fall-out’ from the House of Lords’ bare majority decision in *Tinsley v Milligan* [1994] 1 AC 340, HL, to allow informal trusts to be validly asserted, notwithstanding the claimant’s illegality in conveying legal title to the transferee to make improper tax or social security arrangements, provided proof of the informal trust does not require the claimant to ‘rely’ on the forbidden or illegal transaction. In a work on contract law, it is permissible, and perhaps desirable, to end this note on trusts law quite abruptly.

⁴ ‘The Illegality Defence’ (L Com CP No 189: 2009) 1.14.

Although the UK Law Commission's recommendations have no direct effect, the English case law (**13.03**, **13.04**, **13.06**) has followed the lead suggested by the UK Law Commission (see, notably, **13.06** on the English Court of Appeal in *ParkingEye Ltd v Somerfield Stores Ltd* (2012) where the UK Law Commission's discussion was extensively cited).⁵ Unless the relevant contract is expressly or by necessary implication invalidated by statute, the courts are prepared to make a sensitive inquiry whether underlying policy considerations justify barring a contractual claim. This is not a collapse of settled law into a loose discretion (as had been proposed in 1999),⁶ but rather elucidation of policies supporting the inherited body of law to ensure those policies are properly pursued and not overplayed (see the discussion by Toulson LJ noted in *ParkingEye Ltd v Somerfield Stores Ltd*, 2012).⁷ However, Lord Neuberger in the Supreme Court of the United Kingdom in *Bilta (UK) Ltd (in liquidation) v Nazir (No 2)* (2015) said⁸ that it would be necessary for the Supreme Court in a future case to return to the fundamental question whether the *ex turpi causa* doctrine should be rooted in a clear application of legal doctrine (shorn of value judgments) or whether a more fluid discretionary approach is required.

13.02 What are those policies? The UK Law Commission's 2009 Consultation Paper's 'The Illegality Defence' suggests this list:⁹

- (1) whether barring the claim will further the purpose underlying the offence or head of public policy;
- (2) whether allowing the claim will create unacceptable inconsistency between actionable civil rights and the relevant offence or head of public policy;
- (3) that the claimant should not be allowed to benefit, or perhaps make positive claims, in respect of his criminal or perhaps other serious wrongdoing;
- (4) whether the barring of the claim will send a salutary and appropriate deterrent message to others similarly placed that they should not lightly commit the relevant offence or infringe the item of public policy;
- (5) whether barring the claim is appropriate or necessary in order to protect the civil process against abuse of its mechanisms;
- (6) possibly (this policy being the subject of intense dispute) whether the barring of the claim is appropriate in order to punish the claimant for his wrongdoing or moral turpitude.

Building on this list of policies, the UK Law Commission in 2009¹⁰ articulated various 'factors' that the court might consider when applying the existing law to particular contexts:

- (a) 'whether the claim would undermine the purpose of the prohibiting rule';
- (b) 'the seriousness of the offence';

⁵ [2012] EWCA Civ 1338; [2013] QB 840, at [30], [31], *per* Jacob LJ, and at [48]–[52], *per* Toulson LJ.

⁶ 'Illegal Transactions; the Effect of Illegality on Contracts and Trusts' (L Com CP No 154: 1999).

⁷ [2012] EWCA Civ 1338; [2013] QB 840, at [48].

⁸ *ibid*, at [13]–[17]; noting also *R (on the application of Best) v Chief Land Registrar* [2015] EWCA Civ 17; [2015] 4 All ER 495, notably Sale LJ at [51]–[61].

⁹ 'The Illegality Defence' (L Com CP No 189: 2009) 2.5–2.29.

¹⁰ *ibid*, 3.126ff.

- (c) ‘the causal connection between the claim and the illegal conduct’;
- (d) ‘the comparative guilt of the parties’;
- (e) ‘the proportionality of denying the claim’.

The UK Law Commission concluded, first, that ‘ultimately a balancing exercise is called for which weighs up the application of the various polices at stake’; secondly, the defence of illegality to a contractual claim should succeed ‘only when depriving the claimant of his or her contractual rights is a proportionate response based on the relevant illegality policies’.¹¹ In its 2010 report, ‘The Illegality Defence’, the UK Law Commission suggested that the courts are now moving away from a ‘mechanistic’ application of the illegality bar.¹²

13.03 *The Ex Turpi Causa Defence*: The illegality defence (*ex turpi causa non actio oritur* or ‘no civil claim can be founded on an unlawful or wicked ground’) has a long history. The defence is not confined to contract law.¹³ In *Hounga v Allen* (2014) Lord Hughes noted that a claimant who is party to an unlawful arrangement (the claimant had knowingly entered the country as an illegal immigrant) is *prima facie* prevented from taking advantage of the wrongdoing.¹⁴

Modern law has abandoned an over-fastidious, over-reactive, mechanistic or myopic approach to this defence. In *Gray v Thames Trains Ltd* (2009)¹⁵ Lord Hoffmann suggested that the *ex turpi causa* principle cannot be reduced to a single criterion:¹⁶ ‘The maxim *ex turpi causa* expresses not so much a principle as a policy. Furthermore, that policy is not based upon a single justification but on a group of reasons, which vary in different situations.’

In *Hounga v Allen* (2014) the Supreme Court of the United Kingdom held that an illegal immigrant, who had been unlawfully brought into England from Nigeria when she was a young teenager, should be permitted to claim for racial discriminatory dismissal against her employer.¹⁷ The claim (which was remitted to the first instance tribunal for further investigation) arose out of a contractual relationship but the cause of action was not based on breach of contract. She had served unpaid as an au pair in the employer’s household. She had in effect been coerced into acting as the latter’s household slave for a period of eighteen months and then been shown the door and dumped on the (British) streets. The UK Supreme Court’s unanimous decision is a convincing application of public policy. For it would be quite unconvincing to allow this young person’s complicity in

¹¹ ‘The Illegality Defence’ (UK L Com CP No 189: 2009) 3.142.

¹² ‘The Illegality Defence’ (UK Law Commission No 320: 2010) 1.11ff, especially 3.10ff.

¹³ eg, in *Safeway Stores v Twigger* [2010] EWHC 11 (Comm); [2010] 3 All ER 577, the defence was considered in the context of claims pleaded as breach of contract, breach of fiduciary duty, and negligence.

¹⁴ [2014] UKSC 47; [2014] 1 WLR 2889, at [56].

¹⁵ [2009] UKHL 33; [2009] 1 AC 1339 (noted by P S Davies (2009) 125 LQR 557).

¹⁶ *ibid*, at [30]; cited by the English Court of Appeal in *ParkingEye Ltd v Somerfield Stores Ltd* [2012] EWCA Civ 1338; [2013] QB 840, at [30], [31], *per* Jacob LJ, and at [55], *per* Toulson LJ; and in the tort context, *Joyce v O’Brien* [2013] EWCA Civ 546; [2014] 1 WLR 70, especially at [22], [27]–[29], [47], [52], *per* Elias LJ.

¹⁷ [2014] UKSC 47; [2014] 1 WLR 2889.

illegal trafficking to preclude her from claiming compensation in respect of her discriminatory treatment.

In *Les Laboratoires Servier v Apotex Inc* (2015)¹⁸ the Supreme Court held that it would be inappropriate for the *ex turpi causa* principle to be engaged in respect of the commission in a foreign jurisdiction of the tort of patent infringement (the patent concerned a pharmaceutical drug). In this case A had obtained in England an interim injunction against B in respect of B's patent infringement in England. The injunction was later discharged. A resisted liability under the cross-under-taking on the ground that B had been found guilty in Canada of having infringed A's patent by producing goods covered by A's patent. The Supreme Court of the United Kingdom held unanimously that the Canadian misconduct was not serious enough to support the defence of *ex turpi causa*. The result was that A remained liable to pay compensation under the cross-undertaking in respect of B's loss suffered during the currency of the relevant interim injunction. But there should be subtracted from that compensatory award the amount of damages payable in Canada in respect of B's patent infringement in that foreign jurisdiction.

The connection between the claimant's wrongdoing and the cause(s) of action was held to be too strong to permit the claim in *Stone & Rolls Ltd v Moore Stephens* (2009).¹⁹ Here a majority of the House of Lords (Lords Phillips, Brown and Walker) held that the *ex turpi causa* principle prevented the liquidator of a company from successfully bringing contractual or tortious claims against auditors who had failed to identify that the company was being run fraudulently as a 'one man company'. The liquidator was the extension of the company and the company was in turn inextricably represented by the fraudster. The result was that both a contract and concurrent tort claim for damages failed. But this decision was declared by Lord Neuberger in the Supreme Court of the United Kingdom in *Bilta (UK) Ltd (in liquidation) v Nazir (No 2)* (2015)²⁰ to be deeply problematic and he said that it should not be relied upon beyond that case's immediate ground of decision concerning the company liquidator's claim against the allegedly negligent auditors of a corruptly run company.

Saunders J, sitting in the Hong Kong Court of First Instance, in *Sime Winner Holdings Ltd v Tan Wan Hong* (2009)²¹ discussed the defence of illegality in some detail. In this case, the plaintiffs sued a Mr Tan for breach of fiduciary duty in his capacity as an officer/employee of Sime Winner, and CM2 Ltd ('CM2') for breach of fiduciary duty in its capacity as an agent of Sime Winner. Sime Winner sought to recover from Mr Tan two sums, US\$1,463,496.41, and HK\$2,348,427, which

¹⁸ [2014] UKSC 55; [2015] AC 430 (a five-judge panel: Lords Neuberger, Mance, Clarke, Sumption, and Toulson).

¹⁹ [2009] UKHL 39; [2009] 1 AC 1391 (noted by P Watts (2010) 126 LQR 14–20; and D Halpern (2010) 73 MLR 487; considered in *Safeway Stores v Twigger* [2010] EWHC 11 (Comm); [2010] 3 All ER 577 on the issue of corporate liability); also considered in *Moulin Global Eyecare Trading Ltd (in liq) (formerly known as Moulin Optical Manufactory Ltd) v Commissioner of Inland Revenue* [2011] 3 HKLRD 216; [2011] 2 HKC 545; [2011] HKCU 288; distinguished in *Hotung Investment (China) Ltd v Ernst & Young (sued as a firm)* [2012] 5 HKLRD 421; [2013] 1 HKC 127; [2012] HKCU 2225.

²⁰ [2014] UKSC 23; [2015] 2 WLR 1168, at [30].

²¹ *Sime Winner Holdings Ltd v Tan Wan Hong* [2009] HKEC 606.

were received by CM2 as an agent of Sime Winner. The case for Sime Winner was that Mr Tan misappropriated those sums for himself. There was no dispute that virtually the whole of the two sums were withdrawn on Mr Tan's instructions and applied in payments in respect of himself and his sometime mistress, Ms Loh Poi Yan. The case for Mr Tan was that if the sums at issue belong to Sime Winner, the court should not give relief to Sime Winner because, he asserted, the relationship between Sime Winner and CM2 was void for illegality. It was alleged that (1) the importation of motor vehicles into the PRC by CM2 involved the under-declaration of the value of vehicles for PRC customs purposes, a form of smuggling and an illegal act under PRC law; (2) the remittance of funds from the PRC, by TJZY (a PRC motor vehicle distributor, Tianjian Zhong Yin Mechanical & Electrical Equipment Company Ltd) to CM2, constituted, in part, the remittance of funds illegally obtained as a result of the under-declaration of the value of the vehicles, and consequently another offence under PRC law; (3) the use of the 'underground banking system' to remit funds from the PRC by TJZY to CM2, constituted a breach of PRC currency control regulations. All of these illegalities, Mr Tan asserted, mean that the funds held by CM2 are tainted with illegality, and the court should not act in favour of Sime Winner because to do so would be to enable Sime Winner to recover monies paid under an illegal contract.²²

Sounders J considered in *Sime Winner Holdings Ltd v Tan Wan Hong* (2009)²³ that the wide scope of the assertions in *Scott v Brown* (1892) was greatly reduced in the judgment of Lord Browne-Wilkinson in *Tinsley v Milligan* (1994). Mr Tan's defence based on illegality was rejected. It was held that there was nothing in the relationship between Sime Winner and CM2 was illegal under Hong Kong law;²⁴ and even if the funds received by CM2 for Sime Winner were tainted by illegality, that illegality was merely a part of the background and did not afford a defence to a claim by Sime Winner against either Mr Tan or CM2.²⁵

13.04 *Public Policy and Tort Claims: Gray v Thames Trains Ltd* (2009) concerned a claim for lost earnings, and other damages, stemming from the claimant's imprisonment for homicide. He had killed a pedestrian, with whom he had had an argument, by running to a relative's nearby flat, grabbing a kitchen knife, chasing the pedestrian, and stabbing him. This willingness to kill in response to trivial provocation had been triggered by the trauma of a train crash, two years before (the Ladbroke Grove rail disaster), in which the claimant had been injured. That injury was the result of the defendant train company's negligence.²⁶ The House of Lords held that the *ex turpi causa* principle precluded Gray's claim for damages. The claimant's act of criminal homicide was voluntary conduct. The law could not offer compensation for loss consequent upon the claimant's conviction for that criminal wrong.

²² *ibid.*

²³ *ibid.*

²⁴ *ibid.*, at [104]; applying *Ralli Brothers v Compania Naviera Sota Y Aznar* [1920] 2 KB 287 and *Dow MFB Ltd v Detrick Ltd* [1988] 1 HKLR 344.

²⁵ *Sime Winner* case [2009] HKEC 606, at [104], considering *Peconic Industrial Development v Chio Ho Cheong* (unreported, HCA 16255/99), *per* A Cheung J, at [537]–[541].

²⁶ *Sime Winner* case [2009] HKEC 606, at [20]–[23].

(2) Agreements to Commit a Legal Wrong

13.05 Agreements are illegal, and hence unenforceable, if they involve an undertaking to commit a crime²⁷ (certainly if both are conspiring to commit a deliberate wrong,²⁸ but perhaps also even if neither party is aware of the criminality,²⁹ although this aspect of the law is not clear).³⁰ Indeed an agreement to commit a crime is invalid, and indeed the agreement itself constitutes the criminal wrong of criminal conspiracy. The courts will be prepared to examine whether there was a possibility of the contract being performed in a lawful fashion, if the parties had not at first committed themselves to an unlawful purpose.³¹ An agreement is also illegal if the parties jointly and deliberately undertake to commit a legal wrong, such as a tort or breach of trust. But if one party was unaware that performance would involve a *civil wrong*, the better view is that he is entitled to recover the relevant fee, etc, for the whole of his performance, and not just for that part which was not unlawful. This is Treitel's³² attractive suggestion concerning a loose end within *Clay v Yates* (1856),³³ where a publisher was entitled to payment for the work he had done before he realised that the remaining part of the job would involve a libel upon a third party. Payment cannot be obtained if it was made conditional on performance of an unlawful act. At the time of *Beresford v Royal Insurance Co Ltd* (1938)³⁴ suicide was a crime. The life insurance policy in that case covered suicide. It was held that the successful suicide's estate could not claim insurance on this policy.³⁵ However, an agreement to indemnify a person for his legal costs in civil proceedings is not unlawful, even though the misconduct involved criminal and civil wrongdoing, provided the agreement to indemnify is made after the criminal and civil wrongdoing has already taken place³⁶ (the facts concerned a

²⁷ For discussion of the *ex turpi causa* principle in the context of injury sustained during performance of a joint enterprise to steal, *Joyce v O'Brien* [2013] EWCA Civ 546; [2014] 1 WLR 70, especially at [22], [27]–[29], [47], [52], *per* Elias LJ.

²⁸ *eg*, *Taylor v Bhail* [1996] CLC 377, CA (headmaster of school and builder agreeing to inflate apparent price of repair work by £1,000; in return, builder awarded the job; builder's action for unpaid part of price failed both in contract law, because of illegal arrangement to defraud insurance company, and in restitution law, because he was party to the scam).

²⁹ *JM Allan (Merchandising) v Cloke* [1963] 2 QB 340, 348, CA, *per* Lord Denning MR (roulette wheel hired by defendant initially for an unlawful purpose, although neither party was aware of this; owner of wheel unable to claim for hire; wheel had been returned by defendant); noted, 'Illegal Transactions: The Effect of Illegality on Contracts and Trusts' (L Com CP No 154: 1999) 2.20.

³⁰ L Com CP No 154: 1999, at 2.22, noting the contrary suggestion by Pearce LJ in *Archbalds (Freightage) Ltd v S Spanglett Ltd* [1961] 1 QB 374, 387, CA.

³¹ *Waugh v Morris* (1873) LR 8 QB 202.

³² G H Treitel, *The Law of Contract*, edited by E Peel (13th edn, Sweet & Maxwell, 2011) 11-016.

³³ (1856) 1 H & N 73.

³⁴ [1938] AC 586, HL.

³⁵ Now the problem would not arise, because the Suicide Act 1961 decriminalised suicide; however, for the continuing problem concerning suicide pacts, and the crime of aiding and assisting suicide, *Dunbar v Plant* [1998] Ch 412, CA (limited scope for statutory relief against forfeiture of benefits obtained from the successful suicide's estate by the unsuccessful attempted suicide); applied in *Glover v Staffordshire Police Authority* [2006] EWHC 2414 (Admin); [2007] ICR 661.

³⁶ *Mulcaire v News Group Newspapers Ltd* [2011] EWHC 3469 (Ch); [2012] Ch 435, at [45], *per* Sir Andrew Morritt C.

newspaper's agreement to indemnify its employees for legal costs arising from the phone hacking scandal).

(3) Incidental Illegality during Performance: A Flexible Approach

13.06 Here the problem is as follows. During the course of performance, a party commits (as he was aware from the contract's commencement that he might) an unlawful act, or perhaps a series of unlawful act. The other party is not implicated. The contract was capable of lawful performance. The illegality is not part of the central performance of the contract. Later, the innocent party snatches at this in order to terminate and to escape liability to pay or to do its part. In such a situation, the English Court of Appeal in *ParkingEye Ltd v Somerfield Stores Ltd* (2012)³⁷ emphasised the need to avoid a mechanical, 'unduly sanctimonious',³⁸ and disproportionate³⁹ application of principles of public policy and illegality. Toulson LJ refused to recognise:⁴⁰ 'a fixed rule that any intention from the outset to do something in the performance of the contract which would in fact be illegal must vitiate any claim by the party' because such an approach would be 'too crude and capable of giving rise to injustice'.

The facts of *ParkingEye Ltd v Somerfield Stores Ltd* (2012) were as follows. The claimant agreed for fifteen months to provide the defendant supermarket chain with an automated car-park monitoring and control system. This system enabled the claimant to collect charges from any customer whose vehicle remained parked beyond the free parking period (these charges would be debts owed by customers to the supermarket;⁴¹ these sums were held not to be penalties (**12.51**), but were instead recoverable liquidated sums; but higher charges imposed for very late payments would be penalties). The claimant would pocket these charges and would thus have an incentive to pursue these claims aggressively. After several months, the defendant terminated the contract on the basis that the claimant had made illegal representations in demand letters (the third demand letter in the escalating sequence) sent to customers, thereby committing the civil wrong of deceit vis-à-vis those customers. The main falsehood⁴² was that the claimant had authority to bring civil proceedings against the overstaying parties who failed to pay the relevant charges.

The English Court of Appeal concluded in *ParkingEye Ltd v Somerfield Stores Ltd* (2012) that the defendant's reliance on illegality as a ground for terminating the contract and refusing to make payments would lead to the disproportionate result that the defendant would be exonerated from paying over £300,000 for the claimant's lost revenue under the fifteen month contract. The illegality was incidental

³⁷ [2012] EWCA Civ 1338; [2013] QB 840.

³⁸ *ibid.*, at [38], *per* Jacob LJ.

³⁹ *ibid.*, at [38] and [39], *per* Jacob LJ; and at [79], *per* Toulson LJ.

⁴⁰ *ibid.*, at [63].

⁴¹ *ibid.*, at [22].

⁴² *ibid.*, [59], *per* Toulson LJ; at [11], *per* Jacob LJ, for details of other false information contained in the claimant's 'third' standard letter.

to only part of the performance of the contract and was far from central to it.⁴³ Once the defendant had become aware of the objectionable nature of the third letter, it should have drawn it to the claimant's attention and the claimant would have stepped into line and eliminated the element of deceit.⁴⁴ To decide otherwise would confer a windfall reward for the defendant.

(4) Agreements Prohibited by Statute

- 13.07** An agreement might sometimes be prohibited, whether expressly or by 'necessary implication',⁴⁵ by statute with the result that neither party can enforce it, not even a party who is unaware of the relevant prohibition (for possible escape from this, **13.08**). In *Re Mahmoud and Isphani* (1921),⁴⁶ statute required licences for the sale and purchase of linseed oil. The defendant falsely told the plaintiff that he had a licence. The plaintiff had a licence. When the defendant refused to accept delivery, the plaintiff sued for damages. The defendant successfully pleaded the defence of illegality. The English Court of Appeal held that the defence, however unmeritorious on these facts (Banks LJ described the defendant's stances as 'shabby'),⁴⁷ should prevail because the contract was expressly prohibited by the statute, unless both parties were licensed.
- 13.08** By contrast, *Browne-Wilkinson J in Nash v Halifax Building Society* (1979)⁴⁸ held that a building society could recover money advanced under a contract of loan supported by a mortgage (the 'second' mortgage on the relevant property) even though statute⁴⁹ prohibited building societies from making loans on the security of property already subject to a mortgage or charge in favour of a third party. The judge said, with abundant common sense: 'the section is designed to protect the building society as a whole and, accordingly, although the transaction was illegal, the society is entitled to recover moneys advanced under such an advance and enforce the security given for its repayment.' Similarly, the English Court of Appeal in *Hughes v Asset Managers plc* (1995) drew back from construing a statute, requiring investment contracts to be drawn up only by licensed investment agents, as an implied prohibition upon formation of the relevant contracts. Otherwise, as Saville LJ observed,⁵⁰ the invalidity of all such contracts would have catastrophic consequences not only for investment companies (who might be expected in general to be capable of being diligent to avoid this hazard, and who are normally cash recipients) but, on the other side of this transaction, for investors, that is, institutions and ordinary members of the public. The same risk of total invalidity having an unmerited and harsh impact upon innocent non-professionals

⁴³ *ibid.*, at [71].

⁴⁴ *ibid.*, at [68] and [78].

⁴⁵ R A Buckley, 'Implied Statutory Prohibition of Contracts' (1975) 38 MLR 535.

⁴⁶ [1921] 2 KB 716, CA (Atkin, Scrutton, Banks LJJ); similarly, the innocent claimant in *Chai Sau Yin v Liew Kwee Sam* [1962] AC 304, PC, noted Law Commission, 'Illegal Transactions; the Effect of Illegality on Contracts and Trusts' (L Com CP No 154: 1999) at 2.18.

⁴⁷ [1921] 2 KB 716, 724, CA.

⁴⁸ [1979] Ch 584, 591.

⁴⁹ Section 32, Building Societies Act 1962.

⁵⁰ [1995] 3 All ER 669, 674, CA.

explains why the UK Financial Services and Markets Act 2000 enables insured persons (but not insurance companies) to sue on insurance contracts, where the relevant insurance business is transacted in breach of the regulatory system.⁵¹

In Hong Kong, illegal workers under illegal employment contracts performing lawful work were allowed to claim employees' compensation. In *Yu Nongxian v Ng Ka Wing & Another* (2008), the deceased, a mainland illegal worker was not lawfully employable under the Immigration Ordinance. He nevertheless took up employment and fell to his death when demolishing an illegal canopy. His dependents brought a claim for employees' compensation against the 1st respondent, Ng Ka Wing, named as the employer. Since Mr Ng was not insured, the Employees' Compensation Assistance Fund Board, a statutory body set up under the Employees Compensation Assistance Ordinance (Cap 365) was joined as 2nd respondent. The claim was dismissed by H H Judge Chow holding that the claimants had failed to establish that Ng was the employer of the deceased. The Hong Kong Court of Appeal reversed the decision, holding that on the evidence properly approached, Ng's identity as the employer had plainly been established. It was held that the discretion given by section 2(2) of the Employees' Compensation Ordinance to award compensation notwithstanding the illegality of the deceased's contract of employment ought to be exercised in favour of the claimants. In particular, Tang V-P, sitting in the Hong Kong Court of Appeal in this case held that allowing compensation claims by illegal employees under section 2(2) was more conducive to serving the public policy regarding unemployable persons performing lawful work.⁵² The Hong Kong Court of Final Appeal found that the discretion in section 2(2) is in the widest terms and refused leave to appeal against the Hong Kong Court of Appeal's decision.⁵³

13.09 In other cases, the court is asked to determine whether the relevant statutory offence has impliedly prohibited a type of contract. In *St John Shipping Corporation v Joseph Rank Ltd* (1957)⁵⁴ Devlin J held that on construction a statutory offence did not entail implied prohibition of the relevant contract. Here, the plaintiff shipper had been fined by magistrates for the statutory offence of overloading a ship, but the fine had not kept up with inflation. The defendant charterer, ostensibly *pour encourager les autres*, withheld some of the freight payable under the contract of carriage, pleading as a defence that the plaintiff's performance of the contract had been illegal. Devlin J declined to find that the contract had been impliedly prohibited.⁵⁵

Devlin J also held that there was no reason to invalidate the claim for freight merely because the plaintiff had knowingly performed the contract in an illegal

⁵¹ Section 28, Financial Services and Markets Act 2000 (for the unfortunate case law background, notably *Phoenix General Insurance Co of Greece SA v Halvanon* [1988] QB 216, 273, CA, which necessitated this change, 'The Illegality Defence' (L Com CP No 189: 2009) 3.101).

⁵² [2007] 4 HKLRD 159; applied in *Chen Xiu Mei v Li Siu Wo* [2008] 2 HKLRD 211.

⁵³ [2008] HKEC 99.

⁵⁴ [1957] 1 QB 267.

⁵⁵ [1957] 1 QB 267, 289; for similar remarks on the proliferation of statutory offences of varying heinousness and technicality, *Shaw v Groom* [1970] 2 QB 504, 523, CA, *per* Shaw LJ; see also *Ever-Long Securities Co Ltd v Wong Sio Po* [2004] 2 HKLRD 143.

fashion. He argued that it could not be shown that the defendant's cargo had itself directly led to the overloading. (This case was considered in *ParkingEye Ltd v Somerfield Stores Ltd*, 2012).⁵⁶

In *Ever-Long Securities Co Ltd v Wong Sio Po* (2003), the Hong Kong Court of Appeal overturned the decision of the Hong Kong Court of First Instance and held that, among others, (i) the plaintiff's breach of the rules set out in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the Code) would not render the Margin Client's Agreement concerned void or illegal; (ii) the requirement of Pt XA of the Securities Ordinance (Cap 333) did not apply and the failure to comply with those statutory requirements could not form the basis of a challenge on illegality.⁵⁷ In this case, the Hong Kong Court of Appeal found that it was not disputed that the statements provided by the plaintiff (both transaction and monthly) did not contain the statutory requirements under section 121Z in Division 3 of Pt XA. Given that section 121Z did not explicitly provide for any consequence of failure to meet any of the statutory requirements, it would have been interesting to see whether failure to meet those statutory requirements would necessarily render the contract implicitly illegal, had the court found that Pt XA did apply to the agreement concerned. The Securities Ordinance (Cap 333) was since repealed.

(5) Gambling Contracts⁵⁸

13.10 In Hong Kong, according to the Gambling Ordinance (Cap 148) gambling and lotteries are unlawful unless specifically authorised.⁵⁹ Gambling (賭博) includes gaming, betting and bookmaking.⁶⁰ Under section 14 of the ordinance (Cap 148), any person who provides any money or other property to any other person knowing that it is to be used by any person in or for or in connection with unlawful gambling or an unlawful lottery commits an offence and is liable (a) on summary conviction to a fine of \$500,000 and to imprisonment for 2 years; or (b) on conviction on indictment to a fine of \$500,000 and to imprisonment for 7 years.

In the UK, gambling contracts are no longer invalid. Part 17 ('Legality and Enforceability of Gambling Contracts') of the Gambling Act (UK) 2005 took effect on 1 September 2007. Section 335 of the Act, and associated provisions, repeal the numerous statutes which had invalidated such transactions. The new provision states:⁶¹

- (1) The fact that a contract relates to gambling shall not prevent its enforcement.
- (2) Subsection (1) is without prejudice to any rule of law preventing the enforcement of a contract on the grounds of unlawfulness (other than a rule relating specifically to gambling).

⁵⁶ [2012] EWCA Civ 1338; [2013] QB 840, at [60]–[64], *per* Toulson LJ.

⁵⁷ [2003] HKEC 1358; [2004] 2 HKLRD 143.

⁵⁸ *Smith & Monkcom: The Law of Gambling* (3rd edn, Haywards Heath, 2009).

⁵⁹ Sections 3 and 4 of the Gambling Ordinance (Cap 148).

⁶⁰ Section 2, *ibid.*

⁶¹ Section 335 of the Gambling Act (UK) 2005.

Under the Gambling Act (UK), ‘gambling’⁶² embraces ‘gaming’ (a ‘game of chance for a prize’),⁶³ ‘betting’⁶⁴ and participation in a ‘lottery’.⁶⁵ Gambling contracts are no longer illegal as such. But a gambling transaction might contain some other element which renders the transaction unlawful. That illegal element might arise (1) under the Gambling Act 2005 itself, which creates offences for unlicensed commercial gambling and unlicensed use of premises for gambling purposes;⁶⁶ or (2) outside the statute, for example, where gambling is linked sufficiently with arrangements for the provision of prostitution. In addition, the 2005 Act empowers the Gambling Commission to declare particular bets to be void,⁶⁷ in which case any stake or winnings can be recovered as a debt from the payee.⁶⁸

(6) Public Policy

- 13.11** Other contracts can be invalidated because the agreement is contrary to public policy (regarded by some as an ‘unruly horse’, but by others as a horse that can be mastered by a skilful rider):⁶⁹

I know that over 300 years ago Hobart C.J. said the ‘Public policy is an unruly horse.’ It has often been repeated since. So unruly is the horse, it is said [*per* Burrough J. in *Richardson v Mellish* (1824) 2 Bing 229, 252], that no judge should ever try to mount it lest it run away with him. I disagree. With a good man in the saddle, the unruly horse can be kept in control. It can jump over obstacles. It can leap the fences put up by fictions and come down on the side of justice.

The effect, once again, is to deprive a party of the right to sue on the contract, and to entitle the other to raise illegality as a defence to the contractual claim. A variation on this is that the courts might expose the agreement as a sham transaction,⁷⁰ The main heads are as follows.

- 13.12** *Contracting Involving or Tending to Promote Sexual Immorality*: In *Pearce v Brooks* (1866),⁷¹ the plaintiff coachbuilders could not recover hire charges in respect of its horse-drawn carriage, nor claim for damage caused to this carriage. It had been let in a state which was ‘curiously constructed’, to enable the defendant, a prostitute, to attract clients. It was enough that the plaintiff knew that the contract involved assistance in her ‘immoral calling’. There was no need for the parties to have agreed that the hire would be paid directly from the prostitute’s illicit earnings. Martin B explained:⁷² ‘The [defence] states first the fact that the defendant was to the plaintiff’s knowledge a prostitute; second, that the brougham

⁶² Section 3, *ibid.*

⁶³ Section 6, *ibid.*

⁶⁴ Section 9, *ibid.*

⁶⁵ Sections 14, 15, *ibid.*

⁶⁶ Sections 33, 37, *ibid.*

⁶⁷ Section 336(1), *ibid.*

⁶⁸ Section 336(2), *ibid.*

⁶⁹ *Enderby Town FC Ltd v Football Association* [1971] Ch 591, 606–7, CA, *per* Lord Denning MR.

⁷⁰ *eg*, the cases noted by KR Handley (2011) 127 LQR 171–73.

⁷¹ (1866) LR 1 Exch 213 (Court of Exchequer, Pollock, CB, Martin, Pigott, and Bramwell, BB).

⁷² (1866) LR 1 Exch 213, 219.

was furnished to enable her to exercise her immoral calling; *third, that the plaintiffs expected to be paid out of the earnings of her prostitution.* In my opinion the plea is good if the third averment [passage in italics above] be struck out; and if, therefore, there is evidence that the brougham was, to the knowledge of the plaintiffs, hired for the purpose of such display as would assist the defendant in her immoral occupation, the substance of the plea is proved, and the contract was illegal.’

In *Chuang Yue Chien Eugene v Ho Yau Kwong Kevin* (2002), Ma J (as he then was) overturned the master’s order to strike out certain parts of the amended statement of claim. The defendant contended that, among others, some of the claims were illegal as being contrary to public policy in that they were related to loans allegedly made to the defendant to pay for sexual services of ballroom hostesses and prostitutes. It was held that the relevant part of the amended statement of claim should not be struck out on the illegality ground:

- (1) It is by no means clear on the evidence that the plaintiff is alleging that he actually knew (or wilfully shut his eyes to the obvious fact) that the purpose of the loans was for prostitution. (citing *Pearce v Brooks*, per Pollock CB at 221)
- (2) . . . the defendant, of course, disputes the accuracy of the facts and matters pleaded in para 11 of the original statement of claim and the contents of the plaintiff’s affirmation evidence.
- (3) Even if one could be sure about the state of the plaintiff’s knowledge, the question then arises whether the stated purposes (ballroom hostesses and prostitutes) are of such a character that the court would not enforce the loans intended for such purposes. While the payment of ballroom hostesses and prostitutes for the purpose of having sexual relations is distasteful to many people, the question inevitably arises in the context of illegality whether the immorality is such as to lead to the conclusion that any loan made for such purposes is unenforceable. This question, involving as it does public policy and morality in the present day, is not easy to resolve in a strike out application. The court may, for example, expect evidence of what does or does not constitute modern day morality and whether the patronizing of ballroom hostesses and prostitutes is socially acceptable or not. It is to be noted that prostitution is by itself not unlawful and it may well be the case that their income is taxable by the authorities (thus indicating some form of social acceptability). Nor is the occupation of ballroom hosting unlawful. Hong Kong has many establishments in lawful operation where such persons operate. The cases relied on by Mr Shieh such as *Pearce v Brooks* and the Hong Kong Court of Appeal case of *Ki Hing Lau v Shun Loong Lee* (1910) 5 HKLR 83 were decided in a bygone age where different standards of morality may well have prevailed. It is clear from the judgment of the Chief Justice in *Ki Hing Lau* at 88, that the Court of Appeal was dealing with questions of morality. Whether or not those standards of morality apply now is an important matter that can only really be determined if the court is apprised of the precise facts in the present case (and all nuances) as well as facts going to the more general question of the social acceptability (or otherwise) of the two occupations in question. Public policy is not immutable: see *Chitty on Contracts* Vol 1 at para 17-004. I need give but one example. While in another era, cohabitation by unmarried couples was regarded as immoral

(and this resulted in agreements in this respect being held to be unenforceable) this is certainly not the case nowadays: cf *Chitty on Contracts* Vol 1, at paras 17-067 and 17-068. In Mr Shieh's written submissions, he uses the term 'something to shock the conscience or similar'. The public conscience is not something that is desirable to be dealt with in a strike out application.

- (4) Another question of mixed law and fact also arises in the present case that is not easily disposed of in a strike out application. Even where the intended purpose of the loan is unlawful or contrary to public policy, does it make it any difference to the enforceability of the loan or its repayment if the purpose was not actually carried out? Some cases suggest that if the unlawful or immoral purpose was not carried out, then enforceability is permitted: see, for example, *Appleton v Campbell* (1826) 2 Car & P 347. There are also passages in *Pearce v Brooks* that support this proposition: see the headnote; the judgments of Pollock CB at 218 and Martin B at 219. Mr Shieh disputes the correctness of this proposition and the reading of *Pearce v Brooks* in the way I have set out. It is unnecessary for me to arrive at a concluded view of this difficult aspect of the law of illegality. It is sufficient that I regard the point as arguable and again, it should really be determined when all the facts emerge at trial. In the present case, it is of course very much in dispute for what, if any, purpose the loans were in fact used by the defendant, who in fact denies the existence of the loans in the first place.⁷³

In *Coral Leisure Group Ltd v Barnett* (1981)⁷⁴ Barnett brought a claim for unfair dismissal against a casino company. In his written claim Barnett had alleged (*potentially* self-defeatingly, but see below) that part of his duties was to pay for prostitutes to be used by the Casino's rich clientele. But the UK Employment Appeal Tribunal held that he had not thereby defeated his claim for unfair dismissal: the illegal element in the performance of this contract did not render the entire contract invalid for illegality. It would be different if: (i) the contract had been prohibited by statute, or (ii) if the parties to the contract had formed, from the beginning, the intention of pursuing this illegal purpose. In the absence of (i) or (ii), Browne-Wilkinson J held that the contract could be asserted by the employee.

13.13 *Unacceptable Agreements Concerning Matrimony*: The law on this topic is in a tangle and somewhat outmoded.⁷⁵ It suffices to note *Hermann v Charlesworth* (1905),⁷⁶ which recognises that marriage brokerage is contrary to public policy (an agreement to find a potential spouse for a fee). This remains law, although it appears to be archaic. But mere 'dating agency' services are outside the scope of this rule and hence not unlawful. Secondly, the Supreme Court of the United Kingdom in *Granatino v Radmacher* (2010)⁷⁷ declared that antenuptial and post-nuptial agreements concerning future property arrangements between spouses or prospective spouses, in the event of future separation, are no longer contrary to public policy. The principles enunciated in *Granatino v Radmacher* (2010) are followed

⁷³ [2002] 4 HKC 245.

⁷⁴ [1981] ICR 503, 509, EAT.

⁷⁵ *Treitel's Law of Contract* (12th edn, by E Peel, 2007) 11-036ff.

⁷⁶ [1905] 2 KB 123, CA.

⁷⁷ [2010] UKSC 42; [2011] 1 AC 534; noted J Miles (2011) 74 MLR 430-44 and by J Herring, P G Harris, and R H George (2011) 127 LQR 335-39.

by the Hong Kong Court of Final Appeal in *SPH v SA* (2014).⁷⁸ The most common context concerns the impact of such an agreement on the matrimonial jurisdiction to make property orders consequent on divorce. In that context, the agreement will inform exercise by the court of the discretion (under section 7 of the Matrimonial Proceedings and Property Ordinance (Cap 192)) concerning property distribution, although the court will not be mechanically bound by the agreement when making this decision.⁷⁹

- 13.14** *Servitude*: An agreement to enslave oneself, at least financially, will be contrary to public policy if a party commits himself to a wholly unreasonable restriction upon his personal liberty (other than joining a City law firm) (see *Horwood v Millar's Timber and Trading Company, Limited*, 1916).⁸⁰

In *Treasure Land Property Consultants Limited v Chung, Barick* (1999), the Hong Kong High Court (Court of Appeal) in this case upheld the lower court's decision and found that the contractual provisions relied on by the employer in the case were harsh, oppressive and utterly unreasonable.⁸¹ Rogers JA found that the true effect of those clauses on which the plaintiff relied as consideration was that it operates as a device whereby the plaintiff can, at any time (such as when the relationship between the parties turns sour or when the defendant lands a 'big deal' earning him high commission) deduct 33 per cent of the defendant's total remuneration, under the pretence that this represented consideration for the employee's 'tuition'. The plaintiff can do this for six years, during which time it has been impliedly accepted that the defendant will not be required to attend any training courses. In Burrell J's words, the inequity of this leaves one open mouthed. Godfrey JA agreed, citing Scrutton LJ in *Horwood* (1916) case: 'I am happy to think that it is very seldom that so oppressive a contract as this comes before these Courts, and I am happy also to think that our decision to-day may put an end to similar transactions in future.' Accordingly, the plaintiff's appeal was dismissed.

- 13.15** *Contracts Affecting Foreign Policy*: Both at common law and by statute⁸² contracts involving trade with the enemy are contrary to public policy. The Trading with the Enemy Ordinance (Cap 346) now defines 'enemy'.⁸³

- 13.16** *Agreements to Deceive or Cheat Public Authorities*: In *Miller v Karlinski* (1945),⁸⁴ the English Court of Appeal held that a contract of employment by which the

⁷⁸ [2014] 3 HKLRD 497.

⁷⁹ eg, *LKW v DD* (2010) 13 HKCFAR 537.

⁸⁰ [1916] 2 KB 44, Div Ct.

⁸¹ [1999] HKCU 262.

⁸² Trading with the Enemy Act 1939 (as amended).

⁸³ Section 2, Cap 346.

⁸⁴ (1945) 62 TLR 85, CA; cf *Hall v Woolston Hall Leisure* [2001] 1 WLR 225 (tax fraud; but employee aware but not a participant in the employer's fraudulent avoidance of tax and national insurance payments; employee not precluded from seeking compensation for sex discrimination); followed in *Tsang v Cathay Pacific Airways Ltd* [2002] 2 HKLRD 677; similarly, *Alexander v Rayson* [1936] 1 KB 169 (fraud on rating authority); applied in *Kowloon Garage v Kwong Tai Company Limited* [1949] 33 HKLR 88; [1949] HKCU 8; considered in 梁偉志 v 梁麗貞 [2010] 2 HKLRD 812; [2010] HKCU 200; *Mcguire Michael John Edmund v AGW Holdings Ltd (t/a AG Wilkinson & Associates)* [2004] 2 HKLRD 869; [2003] HKCU 1242; *Li Pui Wan v Wong Mei Yin* [1998] 1 HKLRD 84; [1998] HKCU 2570; *Sze Chiu & Anor v*

employee is to be paid a specified weekly sum as salary and to recover from his employer the amount payable out of that sum in respect of income tax by including it in an account for travelling expenses is not severable. The whole contract is illegal as being contrary to public policy and the courts will not entertain an action to enforce any of its terms. No action will therefore lie to recover arrears of salary alleged to be due. The plaintiff's claim for £71, which consisted of £50 for salary and the remainder for expenses, wholly failed. The plaintiff was not entitled to salary because the agreement as to expenses was not a separate part of the contract.⁸⁵

In *McGuire v AGW Holdings Ltd* (2004), the plaintiff (employee) was seeking a claim for wrongful termination and statutory long service payment against his former employer. The plaintiff joined X as a graduate surveyor in 1982. Following an organisational restructuring in 1984, the defendant took over control of X and the plaintiff entered into a new employment contract with the defendant. In 1990, with a view to maximising tax efficiency, the plaintiff and the defendant substituted the employment contract with a consultancy agreement (the 1990 Consultancy Agreement), which provided that the plaintiff worked for the defendant as an independent contractor. In 1995, the 1990 Consultancy Agreement was terminated by both parties and the plaintiff entered into a new employment contract (the 1995 Employment Contract) with the defendant as an assistant director. In 2001, the plaintiff was summarily terminated by the defendant. The plaintiff claimed that the defendant did not have the power to summarily dismiss him and claimed compensation for, inter alia, unused annual leave, payment in lieu of notice and statutory long service payment. For the calculation of the statutory long service payment, the plaintiff claimed that the whole of the period when he was working for the defendant (including periods covered by the 1990 Consultancy Agreement and the 1982 Employment Contract with X should be taken into account). The defendant argued that the plaintiff benefitted from the 1990 Consultancy Agreement in that he could deduct a range of expenses from the fees received under that Agreement and reduce profits tax. Had the plaintiff received those fees as salary from Holdings, he would have had to pay salaries tax and could not have made the deductions allowed by the Revenue in the computation of profits tax. Since the plaintiff derived a benefit from being treated as a consultant for tax purposes, the plaintiff should not now be permitted to resile from his previous position and seek to be treated as an employee during the period of the 1990 Consultancy Agreement so as to obtain more long service pay.

Wong Wang Yee [1979] HKLR 82; [1979] HKCU 18; *Lai Chuen trading as Kin Hing Pantograph Metal Engraving and Electric Manufacturing Factory v Chu Nai Lap* [1973] HKLR 387; [1973] HKCU 33; *H Cynthia Nieh v Kiki Carvalho* [1970] HKDCLR 13; [1970] HKCU 55; *Yung Yeung Shook Chun v Lau Pao Wing* [1964] 2 HKLR 460; [1964] HKCU 60; *Hong Chi Mui trading as Yik Chong Co v Tong Ching Company (A Firm)* [1964] 1 HKLR 146; [1964] HKCU 13; *Lam Sou Kan (No 2) v Siu Ping Sheung* [1962] 2 HKLR 215; [1962] HKCU 33; *Chung Kai Fat v Lung Sang Meat Co* [1966] HKDCLR 111; *Chu Suk-chun v Ma Fuk-sang (t/a Ling Chi Medicine Store)* [1965] HKDCLR 1; *R Lambell v Leung Koon Tung* [1959] HKDCLR 153; *Ki Kwok Hung v Leung Fat Wah* [1958] HKDCLR 66; [1958] HKDCLR 166; distinguished in *Sin Hua Enterprise Co Ltd v The Owners of the Motor Ship Harima* [1987] 4 HKLR 770; [1987] 1 HKC 397; [1987] 2 HKC 118; [1987] HKCU 195.

⁸⁵ (1945) 62 TLR 85, 86, CA.

On this issue, Reyes J sitting in the Hong Kong Court of First Instance in this case, considered Lord Denning's judgment in *Massey v Crown Life Insurance Co* (1978),⁸⁶ and the English Court of Appeal decision in *Young & Woods Ltd v West* (1980).⁸⁷ Held, 'although tempting, one should not prejudge the issue of characterisation [of the plaintiff's relationship with the defendant during the period of the Consultancy Agreement] on the basis that the plaintiff in all likelihood derived a significant tax advantage from entering into the Consultancy Agreement and paying profits tax rather than salaries tax. *If the Court finds that the true relation between Holdings and the plaintiff was all along one of master and servant, it would be open for the Commissioner of Inland Revenue to consider whether or not the plaintiff should be re-assessed to additional tax.*'⁸⁸ There was no allegation that the Consultancy Agreement contravened public policy or was illegal in this case.

In *Li Pui Wan v Wong Mei Yin* (1998),⁸⁹ the Hong Kong Court of Appeal upheld the lower court's decision that the breach of the granting of land by the government to male indigenous villagers was not a breach of a public policy; and that even if it was illegal for the parties to agree to proceed with a sale and purchase or completion at a later date without government approval or before paying the premium, this does not constitute a breach of public policy. Chan CJHC delivered the judgment and summarised the general principles of public policy and illegality as follows:

[A]ccording to the law of contract, if a contract upon its formation or performance contains elements of illegality and is in certain circumstances against public policy the court would not enforce it. What public policy in fact means is that there are certain principles which in the opinion of the court must persist in a civilized society. The question as to whether the court would refuse to enforce a contract depends on the seriousness and turpitude of the illegality. Generally, the court will consider whether the contract is in breach of common law or statute by its formation or performance; or injurious to good government either in the field of domestic or foreign affairs; or interferes with the proper working of the machinery of justice; or injurious to marriage or morality or economically against the public interest.⁹⁰

The purpose of granting of land by the government in accordance with Chinese customary law with additional terms and conditions to New Territories male indigenous villagers is to provide some of the New Territories residents with special care. This situation differs greatly from the principles in the law of contract where the court refuses to make orders to enforce certain contracts because they are against public policy upon formation or performance. The granting of land by the government to indigenous villagers who are male descendents is a measure made under special circumstances. It has nothing to do with the principle

⁸⁶ [1978] 1 WLR 676.

⁸⁷ [1980] IRLR 201.

⁸⁸ [2004] 2 HKLRD 869.

⁸⁹ [1998] 1 HKLRD 84; applied in *Lau Kwai Kiu v Bian Xintian* [2012] 2 HKLRD 954, [2012] HKEC 462 (Civil Appeal Nos 263 and 281 of 2010) and considered in *Best Star Holdings Ltd v Lam Chun Hing* [2012] HKEC 252 (High Court Action No 409 of 2008).

⁹⁰ Citing *Euro-Diam Ltd v Bathurst* [1990] 1 QB 35 and *Edler v Auerbach* [1950] 1 KB 359.

under which by virtue of public policy, certain contracts are found illegal by the court. In our view, such measure adopted by the government in the granting of land should not be regarded as a public policy, and is quite different from the principle in common law which requires the court of law to uphold public policy.

13.17 *Bribery Offences and Corruption*: The common law had invalidated certain forms of agreements involving corruption. In *Amalgamated Society of Railway Servants v Osborne* (1910), the House of Lords held that an MP cannot contract with a third party that he will cast his vote in Parliament in a particular way.⁹¹ And in *Parkinson v College of Ambulance Ltd* (1925),⁹² an agreement foundered under this head because it involved payment for a knighthood. This type of sordid practice is now an offence.⁹³

In England, the topic of bribery is now dominated by the Bribery Act 2010 (England).⁹⁴ This creates offences⁹⁵ concerning the offer, giving, requesting or receipt of a bribe, contrary to reasonable expectations,⁹⁶ for the purpose of causing a function (not confined to public functions)⁹⁷ to be exercised ‘improperly’.⁹⁸ The statute makes tough reading: it is complex and defiantly opaque in structure. The Bribery Act 2010 also addresses the problem of bribery of foreign public officials;⁹⁹ and the issue of foreign customs and expectations.¹⁰⁰

13.18 *Contracts Tending to Pervert the Course of Justice*: An agreement to procure false testimony¹⁰¹ or suppress evidence,¹⁰² or to influence a juror or adjudicator would infringe this head of policy.

⁹¹ [1910] AC 87, HL.

⁹² [1925] 2 KB 1, Lush J.

⁹³ Honours (Prevention of Abuse) Act (UK) 1925.

⁹⁴ Bribery Act 2010; N Cropp [2011] Crim L Rev 122–41; S Gentle [2011] Crim L Rev 101–10; J Horder (2011) 74 MLR 911–31 and (2011) 127 LQR 37–54; C Monteith [2011] Crim L Rev 111–21; G Sullivan [2011] Crim L Rev 87–100; A Wells (2011) Business Law Review 186.

⁹⁵ Sections 1 and 2, Bribery Act (UK) 2010; *Hansard*, HL Vol 715, col 1086 (9 December 2009) states: ‘[The Act] creates two general offences of bribery, a third specific offence of bribing a foreign public official and finally a new corporate offence of failing to prevent bribery . . . The general offences, in [sections 1 and 2], cover on one side of the coin the offer, promise and giving of a financial or other advantage, and on the flip side the request, agreeing to receive or acceptance of such an advantage. These offences focus on the conduct of the payer or the recipient of a bribe and describe six scenarios, each involving the improper performance of a function, where one or other offence would be committed. These new offences will apply to functions of a public nature as well as in a business, professional or employment context.’

⁹⁶ Section 5, Bribery Act (UK) 2010.

⁹⁷ Section 3, *ibid*.

⁹⁸ Section 4, *ibid*.

⁹⁹ Section 6, *ibid*.

¹⁰⁰ Section 5(2), *ibid*. (Phillips J had grappled with this problem in *Lemenda Trading Co Ltd v African Middle East Petroleum Co Ltd* [1988] QB 448).

¹⁰¹ *R v Andrews* [1973] QB 422, CA, *per* Lord Widgery CJ: ‘there are few more serious offences possible in the present day, if one excludes violent offences, than those which tend to distort the course of public justice and prevent the courts producing true and just results in the cases before them. This kind of action is akin to perjury, which is always regarded as serious, and we do not think, even having regard to the defendant’s good character, that a sentence of 18 months’ imprisonment is excessive.’

¹⁰² *R v Ali* [1993] Crim L Rev 396 (offence extends to agreement that potential witness should not give evidence); *R v Panayiotou* [1973] 3 All ER 112 (attempt to procure dropping of charge).

In *Lam So Lei v Chan Chit* (2008), a Hong Kong Court of First Instance case, Sakhiani J found that the agreements which provided for payments to the defendant to secure the release of the plaintiff's husband from detention by the authorities in the PRC by a certain time are against public policy and therefore unlawful agreements to make. It was held that the agreements provided for an improper payment to the defendant with the object of interfering with the due course of justice and that it was clearly against public policy to allow the plaintiff to sue on such agreements.¹⁰³

Agreements to take a financial stake in the outcome of the proceedings or to share the fruits of a civil action (damages, etc) remain contrary to common law (so-called 'maintenance and champerty').¹⁰⁴

In Hong Kong, the Law Reform Commission (LRC) released a report on Conditional Fees on 9 July 2007. The report noted that, although conditional fees could enhance access to justice for such persons, conditions were not appropriate for the introduction of conditional fees in Hong Kong. This was because, as the report explained that responses from the insurance industry to an earlier consultation paper issued by the LRC suggested that it was unlikely that there would be long term and affordable insurance (called 'after-the-event' insurance) to cover the opponent's legal costs in the event the legal action fails. Given the widespread support on consultation for the expansion of the Supplementary Legal Aid Scheme, the report recommends that the Hong Kong government should increase the financial eligibility limits of the Supplementary Legal Aid Scheme, as well as expanding the types of cases covered by the scheme. Subsequently, the financial eligibility limits were raised in May, 2011, and the types of cases were expanded in November 2012.¹⁰⁵

The report has further recommended the setting up of a Conditional Legal Aid Fund ('CLAF') to screen applications for the use of conditional fees, brief out cases to private lawyers, finance the litigation, and pay the opponent's legal costs should the litigation prove unsuccessful. Neither the Hong Kong Bar Association nor the Hong Kong Law Society supported the establishment of a CLAF.¹⁰⁶ The LRC's recommendations concerning the CLAF were rejected by the Administration in October 2010.

In the UK, however, the Courts and Legal Services Act (UK) 1990 (as amended) allows lawyers to agree to conduct a case on a no-win-no-fee basis. This has been

¹⁰³ [2008] HKEC 146.

¹⁰⁴ J Sorabji and R Musgrove, 'Litigation, Costs, Funding, and the Future', in D Dwyer (ed), *The Civil Procedure Rules Ten Years On* (OUP, 2009) 229, at 235, examining the liberal tendency in the modern cases (eg, *Arkin v Borchard Lines Ltd* [2005] EWCA Civ 655; [2005] 1 WLR 3055, at [40]: a non-party 'commercial funder' of litigation brought by A was found liable to pay the victorious party B's costs to the extent that the non-party provided finance in that litigation; funding agreement was not champertous).

¹⁰⁵ The LRC's Report on Conditional Fees (July 2007) is available on the LRC website: <http://www.hkreform.gov.hk/en/publications/rconditional.htm>.

¹⁰⁶ See, eg, the discussion paper of the Hong Kong Legislative Council Panel on Administration of Justice and Legal Services on the Law Reform Commission Report on Conditional Fees, LC Paper No CB(2)1889/09-10(01), available on the LegCo website: <http://www.legco.gov.hk/yr09-10/english/panels/ajls/papers/aj0628cb2-1889-1-e.pdf>.

the foundation for the introduction of (a) conditional fee agreements ('CFAs'), since 1995, and (b) damages based agreements ('DBAs') since April 2013.¹⁰⁷ Both permit a client to enter into a contract for legal services concerning civil litigation or arbitration where the lawyer's remuneration is dependent on his client's success in obtaining a favourable judgment or settlement. A CFA permits a solicitor or barrister in England and Wales to undertake to perform litigation services on the understanding that his normal legal fee will not be payable if the client is unsuccessful in the relevant proceedings; but, if he achieves success for his client, the lawyer will receive an enhanced fee, consisting of his ordinary fee (normally, in the case of solicitors, this will be based on hourly charges) and a percentage of that fee (the percentage 'uplift' cannot exceed 100 per cent). In practice, the victorious lawyer's fee will be paid by the losing party (in accordance with the 'loser must pay' costs rule in English civil proceedings). A DBA is permitted in all fields of civil proceedings.¹⁰⁸ The parent legislation has been supplemented by the Damages-Based Agreements Regulations 2013.¹⁰⁹ However, both CFAs and DBAs remain invalid, under the common law public policy prohibition, if the relevant statutory scheme has not been satisfied.¹¹⁰

More generally, in *Sibthorpe v Southward LBC* (also known as *Morris v Southwark London Borough Council*) (2011)¹¹¹ the English Court of Appeal held that there is no public policy objection, based on the doctrines of champerty and maintenance, in a solicitor providing his client with an indemnity if the case is lost to cover that client's costs liability to the victorious opponent.

In *Unruh v Seeberger* (2007),¹¹² the Hong Kong Court of Final Appeal found that the challenge to the memorandum of agreement (MoA) as a champertous agreement failed. Ribeiro PJJ held (Li CJ, Bokhary, Chan, and McHugh NPJ agreeing) that the scope of maintenance and champerty had shrunk and the courts had developed categories of conduct excluded from the sphere of maintenance or champerty. Two categories of excluded cases were discussed: (i) the legitimate 'common interest' in the outcome of litigation category, including a genuine commercial interest; and (ii) cases involving 'access to justice' considerations.¹¹³ The relevant facts in the case are as follows. Eco Swiss China Time Ltd (ESCT), a Hong Kong company owned by the plaintiff, was involved in an arbitration in the Netherlands regarding a purported termination of an eight-year licence agreement by Benetton International NV (Benetton) and Bulova Watch

¹⁰⁷ *Andrews on Civil Processes* (Intersentia, Cambridge, 2013) vol 1 (*Court Proceedings*) ch 20.

¹⁰⁸ Section 58AA(3)(a), Courts and Legal Services Act (UK) 1990 (amended by section 45, Legal Aid, Sentencing, and Punishment of Offenders Act (UK) 2012); Damages-Based Agreements Regulations 2013/609; CPR 44.18.

¹⁰⁹ See preceding note.

¹¹⁰ eg, in the case of CFAs which fail to comply with the scheme: *Awwad v Geraghty* [2001] QB 570, 596, CA, noted by N Andrews [2000] CLJ 265–67, and *A Walters* (2000) 116 LQR 371–77 (and not following *Thai Trading Co v Taylor* [1998] QB 781, CA, noted by N Andrews [1998] CLJ 469).

¹¹¹ [2011] EWCA Civ 25; [2011] 1 WLR 2111; noted A Sedgwick (2011) 30 CJQ 261.

¹¹² (2007) 10 HKCFAR 31, applied in *Winnie Lo v HKSAR* (2012) 15 HKCFAR 16; followed in *First Laser Ltd* (第一激光有限公司) v *Fujian Enterprises (Holdings) Co Ltd* (華閩(集團)有限公司) (2012) 15 HKCFAR 569.

¹¹³ (2007) 10 HKCFAR 31, paras 89–98.

Co Inc (Bulova). Whilst the arbitration was continuing, in 1992, the plaintiff and defendant 1 (D1) through a series of agreements, including a memorandum of agreement (the MoA), effectively agreed for defendant 2 (D2), a company then wholly owned by D1, to acquire ESCT. Under the MoA, the plaintiff was to use his best endeavours to assist ESCT in connection with the arbitration; the plaintiff was to be paid a special bonus should compensation received by ESCT in respect of the arbitration exceed US\$10 million; and D1 was to pay the special bonus, unless certain conditions were fulfilled (which they never were), in which case D2 was liable to pay. The arbitration and related proceedings were settled by a global settlement with Benetton and Bulova paying ESCT sums over US\$10 million. The plaintiff subsequently commenced proceedings for payment of the special bonus. Both defendants argued that the MoA was champertous and so unenforceable. The Hong Kong Court of Final Appeal upheld the findings of the lower courts rejecting the defendants' arguments on champertous. In particular, it was found that (i) the plaintiff had a genuine commercial interest in the outcome of the arbitration; and (ii) an agreement which was to be performed in relation to judicial or arbitral proceedings in a jurisdiction where maintenance or champerty did not exist, like the Netherlands, should not be struck down in a Hong Kong court on those grounds.¹¹⁴

The question whether maintenance and champerty applied to agreements concerning arbitration taking place in Hong Kong was left open.¹¹⁵ In June 2013, the Hong Kong Law Reform Commission set up a subcommittee, chaired by Ms Kim Rooney, to review the current position relating to third party funding for arbitration for the purposes of considering whether reform is needed, and if so, to make such recommendations for reform as appropriate.¹¹⁶

- 13.19** (i) *Agreement to Oust the Court's Jurisdiction*: Such a contract is illegal. But in the case of arbitration agreements, the Hong Kong Arbitration Ordinance (Cap 609) adopting Articles 7 and 8 of the UNCITRAL Model Law upholds a written arbitration agreement¹¹⁷ and requires that a court shall refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed.¹¹⁸ If the court refers the parties in an action to arbitration, it must make an order staying the legal proceedings in that action.¹¹⁹ The decision of the court to refer the parties to arbitration is not subject to appeal.¹²⁰ On the other hand, the decision of the court to refuse to refer the parties to arbitration is subject to appeal.¹²¹

¹¹⁴ *ibid*, at paras 118–22; *Trendtex Trading Corp v Credit Suisse* [1980] QB 629, *Re Trepcia Mines Ltd (No 2)* [1963] Ch 199, *Giles v Thompson* [1993] 3 All ER 321, *Papera Traders Co Ltd v Hyundai Merchant Marine Co Ltd* [2002] 2 All ER (Comm) 1083 considered.

¹¹⁵ (2007) 10 HKCFAR 31, para 123

¹¹⁶ For the current projects of the HKLRC, see its website: <http://www.hkreform.gov.hk/en/projects/3rdpartyfunding.htm>.

¹¹⁷ Section 19, Arbitration Ordinance (Cap 609).

¹¹⁸ Section 20(1), Arbitration Ordinance (Cap 609).

¹¹⁹ Section 20(5), Arbitration Ordinance (Cap 609).

¹²⁰ Section 20(8), Arbitration Ordinance (Cap 609).

¹²¹ Section 20(9), Arbitration Ordinance (Cap 609).

When Schedule 2 of the Arbitration Ordinance (Cap 609) applies,¹²² as for points of Hong Kong law determined by the arbitrator, the parties can agree that the arbitrator, in making his award, can ‘dispense with reasons’, and thereby the parties can exclude the court’s power to hear an appeal.¹²³ Subject to that, an appeal on a point of law can be referred to the Court of First Instance of the High Court but only if the parties agree or if the court itself grants ‘leave to appeal’, although in this last respect the High Court applies a restrictive set of ‘filtering’ criteria.¹²⁴ The ordinance (Cap 609) does not contain a definition of ‘question of law’, but it is arguable that the ‘question of law’ is confined to Hong Kong law, and that findings of foreign law are beyond the scope of High Court appeal.¹²⁵

- 13.20** (j) *Restraint of Trade*: The courts eschew any general power to invalidate terms or contracts on the ground of reasonableness. But where an arrangement unreasonably stultifies a person’s legitimate interest in pursuing a trade, profession, or otherwise engaging in useful economic activity, the doctrine of ‘restraint of trade’ can invalidate the offending provision (which might be an entire agreement, a free-standing clause, or at least part of a clause which can be excised using the process of ‘severance’,¹²⁶ leaving the remaining portion of the clause operative). The law on this topic is highly detailed, and only a sketch can be provided here. Employment contracts (the doctrine can extend to other forms of association) might provide that upon ceasing to be an employee the former employee will not exploit his trade secrets, or confidential information, or solicit custom from the contacts and names acquired by the employee during his employment with the covenantor (the employee is only released from such a restrictive covenant if he is wrongly dismissed by the employer).¹²⁷ Another well-established form of restraint of trade arises when the seller of a business along with its goodwill (the benefit of its established client-base) agrees with the purchaser not to carry on a business which will compete with the buyer’s newly acquired business. Thirdly, in various other commercial contexts, an agreement might unacceptably preclude a party from exercising a freedom that he might otherwise have. For example, in *Esso Petroleum Co Ltd v Harper’s Garage (Stourport) Ltd* (1968)¹²⁸ the House of Lords struck down a 21-year solus agreement which required the petrol retailer, the owner of the site, not to buy fuel from anyone other than the Esso company.

¹²² Part 11, Arbitration Ordinance (Cap 609).

¹²³ Section 5(2), Schedule 2 of the Hong Kong Arbitration Ordinance (Cap 609); see also section 69(1) of the English Arbitration Act (1996).

¹²⁴ Section 6(4), Schedule 2 of the Hong Kong Arbitration Ordinance (Cap 609); see also section 69(3), the English Arbitration Act (1996).

¹²⁵ For reference, see section 82(1), English Arbitration Act (1996).

¹²⁶ G H Treitel, *The Law of Contract*, edited by E Peel (13th edn, Sweet & Maxwell, 2011) 11–151ff.

¹²⁷ *General Billposting Co Ltd v Atkinson* [1909] AC 118, HL; *Rock Refrigeration Ltd v Jones* [1997] 1 All ER 1, applied in *Midland Business Management Ltd v Ng Pe Lok* [2006] 3 HKC 249.

¹²⁸ [1968] AC 269, HL, considered in *Kao, Lee & Yip (a firm) v Koo Hoi Yan Donald* [1995] 1 HKLR 248; [1994] 2 HKC 228; [1995] HKCU 314; *BSC Building Materials Supply Co Ltd v Cheung Chi Hung Michael* [1998] 2 HKC 425; *AXA China Region Insurance Co Ltd v Pacific Century Insurance Co Ltd* [2003] 3 HKC 1 and followed in *Hummingbird Music Ltd v Dino Acconci* [2010] 1 HKLRD 587; [2010] HKCU 60; [2009] HKCU 105.

In return, the retailer received a reduction in the wholesale price. But a four-year solus agreement was held to fall on the acceptable side of the line (the petrol company was justified to that extent in protecting its interest securing a reasonable degree of continuity in its supply to retailers).¹²⁹

And in *A Schroeder Music Publishing Co Ltd v Macaulay* (1974)¹³⁰ the House of Lords invalidated a music agency agreement under which a 21-year-old songwriter agreed to assign copyright in all his songs composed during the next five years, extendable to ten years if his royalties exceeded £5,000 in the first period. Schroeder was not obliged to publish his works, and Macaulay was subject to the contract for the lengthy periods of five, or even ten years, whereas the publisher could terminate the contract on one month's notice. Macaulay proved to be a success. He successfully applied for a declaration that the contract was void as contrary to public policy, because it was an unreasonable restraint of trade (no relief beyond this bare declaration is mentioned in the law report). The agreement was held to be a restraint of trade and the publisher failed to show that it could be justified as reasonable.¹³¹

13.21 All covenants in restraint of trade must be justified as reasonable both (a) having regard to the interests of the contracting party and (b) to the interests of the public. The promisee (the 'covenantee') bears the burden of establishing (a); but the covenantor bears the onus of establishing (b). The covenant must be aimed at protecting the legitimate interests of the covenantee. In the case of the sale of a business, the buyer has a legitimate interest in protecting the integrity of the established client base—which it has bought—from being undermined by rival competition by the seller. But an employer has no legitimate interest in stopping its former employee from setting up a rival business. Instead its protection is confined to its interests in protecting its trade secrets, or other confidential information, and in preventing the employee from filching his custom by taking advantage of customer details and contacts acquired during the period of employment. The employee's covenant cannot catch types of business different from the covenantee's. Nor must it be excessive in geographical scope. In *Mason v Provident Clothing & Supply Co* (1913) the area specified was work as a canvasser within twenty five miles of London (an area over 1000 larger than the field of the employee's usual field of work), and this was too broad.¹³² Nor should it endure too long.¹³³ Similarly,

¹²⁹ [1968] AC 269, HL, at 301–3.

¹³⁰ [1974] 1 WLR 1308, HL, considered in *Lau Yin Long v Pao On* [1976] HKLR 892; *OTB International Credit Card Ltd v Au Sai Chak Michael* [1980] HKLR 296; [1980] HKC 219; *Amuse Hong Kong Ltd v Chan Kin Tim Leslie* [1994] 1 HKLR 364; [1994] 1 HKC 175; [1994] HKCU 274; *Natuzzi SpA v De Coro Ltd* [2007] 3 HKC 74; applied in *Always Win Ltd v Autofit Ltd (Citybase Property Management Ltd, Third Party)* [1995] 2 HKC 48; and followed in *Hummingbird Music Ltd v Dino Acconci* [2010] 1 HKLRD 587; [2010] HKCU 60; [2009] HKCU 105.

¹³¹ [1974] 1 WLR 1308, HL, at 1313–15, HL.

¹³² [1913] AC 724, HL, considered in *Kleber Emile Marceau Caudron trading as K Caudron & Co (A Firm) v Lorenz Kao* [1964] 3 HKLR 594; *Ho Wing Cheong v Graham Margot* [1991] 1 HKLR 245; *Midland Business Management Ltd v Ng Pe Lok* [2006] 3 HKC 249; and cited in *Degreeasia Limited v Hong Kong Institute of Continuing Education v Paules Lee Siu Yuk* [2010] HKCU 1403.

¹³³ A five-year period was held to be unreasonable in *M & S Drapers v Reynolds* [1957] 1 WLR 9; considered in *Kleber Emile Marceau Caudron trading as K Caudron & Co (A Firm) v Lorenz Kao* [1964]

in cases concerning the sale of a business with goodwill, the length of the period of restraint and its area of operation must be reasonable. However, in *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co Ltd* (1894), the sale of an armaments business contained a restrictive covenant preventing the vendor from engaging in rival trade for 25 years anywhere else in the world. The House of Lords held that this was not excessive, because the vendor, a Swedish millionaire arms producer, had already achieved a worldwide sales base.¹³⁴

(7) Is the Claimant Implicated in the Unlawful Performance?

13.22 *Innocent Party Can Sue if Contract Is Not Prohibited by Statute and Its Performance Does not Necessarily Involve Unlawful Conduct:* If the contract is not expressly prohibited by statute, nor by necessary implication, and provided performance of the agreement will not necessarily entail illegality, a claimant is not disabled from suing on a contract if he has no knowledge of the defendant's illegal performance. In *Archbolds (Freightage) Ltd v S Spanglett Ltd* (1961)¹³⁵ the plaintiff had contracted for the defendant to transport goods by van, not knowing that the defendant's particular van was unlicensed for this purpose and that its use in this way would involve an offence. The plaintiff's goods were lost in transit (they were stolen as a result of the defendant's negligence), and the plaintiff sued for this loss on the basis of contractual breach. The Court of Appeal rejected the defence based on illegality: this was not a case of a contract expressly or implied prohibited; nor had the parties jointly agreed to commit an offence or infringe public policy; nor, finally, had the plaintiff been aware that use of this particular van in this transaction would involve a criminal wrong.¹³⁶

13.23 *Inability to Sue if Claimant Participates in an Unlawful Performance:*¹³⁷ Although the contract is not prohibited by statute, nor does its performance necessarily involve unlawful conduct, the claimant will be unable to sue on it if he became aware that the contract will in fact be performed in an illegal fashion and he becomes implicated in that wrongdoing. He is then precluded by the defence of illegality from being able to enforce the contract. This was decided by the Court of

3 HKLR 594; *Kao, Lee & Yip (a firm) v Edwards* [1994] 1 HKLR 232; [1993] 1 HKC 314; [1994] HKCU 229; and followed in *BSC Building Materials Supply Co Ltd v Cheung Chi Hung Michael* [1998] 2 HKC 425.

¹³⁴ [1894] AC 535, HL; considered in *Kleber Emile Marceau Caudron trading as K Caudron & Co (A Firm) v Lorenz Kao* [1964] 3 HKLR 594; *BSC Building Materials Supply Co Ltd v Cheung Chi Hung Michael* [1998] 2 HKC 425; *AXA China Region Insurance Co Ltd v Pacific Century Insurance Co Ltd* [2003] 3 HKC 1; *Rever (AMA) Salon Ltd v Kung Wai For Dany (No 2)* [2003] 2 HKC 268; applied in *Bridge v Deacons* [1984] AC 705; [1985] 2 HKC 322; and *Oriental Machinery Ltd v Choi Kin On* [2003] 3 HKC 398.

¹³⁵ [1961] 1 QB 374, CA, considered in *Lo Chi Ming v Shum Kim Yuen* [1969] HKDCLR 10; [1969] HKCU 49; *Whitehall Finance Ltd v Win and Fair Securities Co Ltd* [1985] 1 HKC 68; *Johnson, Stokes & Master v Boucher, Trevor Ernest* [1989] 1 HKLR 219; [1989] HKCU 394; and cited in *Tiu Sum Fat v Shun Sing Development Limited* [2010] 1 HKLRD 553; [2010] 1 HKC 258; [2009] HKCU 2130.

¹³⁶ [1961] 1 QB 374, 387–88.

¹³⁷ An article antedating some of the case law examined in this paragraph is R A Buckley, 'Participation and Performance in Illegal Contracts' (1974) 25 NILQ 421.

Appeal in *Ashmore, Benson, Pease & Co Ltd v AV Dawson Ltd* (1973).¹³⁸ Here the defendant agreed to transport the plaintiff's goods, but the defendant overloaded its lorry, contrary to statute. The defendant knew this was an offence. The plaintiff's goods were damaged when the lorry toppled over. The plaintiff's contractual claim for this loss failed. Its employee had been consciously implicated in the illegal performance by the defendant of the contract: the plaintiff's manager knew that the loading had involved breach of the relevant statute; indeed this had happened before; and, furthermore, the plaintiff company's connivance in this criminal activity enabled it to make a saving in its transport costs.¹³⁹

13.24 In *Hall v Woolston Hall Leisure* (2001),¹⁴⁰ Mance LJ suggested that the *ratio* of the *Ashmore* case (preceding paragraph) involved not merely the claimant's knowledge of the criminal activity but participation in that wrongdoing, in the sense that the claimant was not merely turning a blind eye to the wrong, but collusively making a gain from this acquiescence. In *Anglo Petroleum Ltd v TFB (Mortgages) Ltd* (2007),¹⁴¹ Mummery LJ noted that participation does not arise solely from knowledge of the other's criminal or unlawful use of the relevant object or service. If that were so, no one could sue on a contract to supply basic living items (food and ordinary clothing) to a prostitute. It appears, therefore, that the courts will have regard to the special nature of the goods or services supplied (the 'ornamental carriage' in *Pearce v Brooks*, **13.12**), whether the supplier is directly profiting from the defendant's illegal activity (as in the *Ashmore* case, **13.23**), the heinousness of both the claimant's activity (repeated dealings, as in the *Ashmore* case) and the defendant's wrongdoing (for example, the liquidator of a former quarrying business sells detonators to suspicious laymen, and it turns out that they are terrorists). But the law has not been fully worked out, as Mummery LJ's judgment in the *Anglo Petroleum* case (2007) shows.¹⁴²

(8) Consequences of Illegality

13.25 There are seven main propositions. First, where the contract is expressly or by necessary implication prohibited by contract, neither party can sue on it (**13.07** to **13.09**). Secondly, the same applies where the contract is invalid because the common purpose of the transaction was to commit a crime or other (serious) legal wrong (**13.05**). Thirdly, we have seen that the claim upon a contract might not fail if the claimant was not aware of and implicated in the defendant's decision to perform it in an illegal fashion (**13.22** and compare the situation where the claimant does participate in unlawful performance, **13.23**); and relatedly the claimant will be able to sue if he has been guilty of only incidental illegality during

¹³⁸ [1973] 1 WLR 828, CA; considered in *Byjoy Ltd v Thorogood Estates Ltd* [1985] 2 HKC 746; [1983–85] CPR 551; *Cheng Ah Hung Bernard v Chintung Commodities Ltd* [1985] 1 HKC 318; and cited in *Tiu Sum Fat v Shun Sing Development Limited* [2010] 1 HKLRD 553; [2010] 1 HKC 258; [2009] HKCU 2130.

¹³⁹ [1973] 1 WLR 828, 833, CA.

¹⁴⁰ [2001] 1 WLR 225, at [80]; considered in *Tsang, Helen v Cathay Pacific Airways Limited* [2002] 2 HKLRD 677; [2001] HKCU 1057.

¹⁴¹ *Anglo Petroleum Ltd v TFB (Mortgages) Ltd* [2007] EWCA Civ 456; [2007] BCC 407.

¹⁴² *ibid.*, at [73]–[82].

performance (13.06). Fourthly, sometimes the courts have found that, despite the invalidity of the principal contract, the claimant has a separate action for the tort of deceit¹⁴³ committed by the defendant, or that there is a valid claim for breach of a collateral contract.¹⁴⁴ Fifthly, the claimant might be entitled to a claim for recovery of money paid or for a *quantum meruit* in respect of services or a *quantum valebat* for goods delivered.¹⁴⁵ Sixthly, the fact that possession in property has been acquired under an illegal contract does not preclude an action by the claimant owner to recover that property (or to obtain damages for conversion, in the case of chattels).¹⁴⁶ Finally, property can pass under an illegal contract by which title was intended to be transferred.¹⁴⁷

13.26 If the contract is illegal, the starting point is that the defendant can *prima facie* raise the defence of illegality to the claimant's action for restitution. Examples where this rule operates satisfactorily are *Parkinson v College of Ambulance Ltd* (1925),¹⁴⁸ where the plaintiff had made a large donation to charity, following the charity's suggestion that it could reciprocate by procuring him a knighthood. His claim to recover on the basis of total failure of consideration was met by the defence of illegality. And in *Berg v Sadler & Moore* (1937), the plaintiff used false pretences to buy cigarettes from a tobacco association, and he was unable to recover his money from the intended seller.¹⁴⁹ However, there are exceptions to the claimant's inability to obtain restitution under a contract which is invalid

¹⁴³ *Shelley v Paddock* [1980] QB 384, 357, CA (the defendant swindled the claimant into paying for property not in fact owned by the defendant; but the claimant had breached exchange control rules; action based on the defendant's fraudulent misrepresentation that he was owner permitted): for an argument that sometimes the defendant might be held to have assumed a tortious duty to save the claimant from the trap (known to, or reasonably ascertainable by) a more knowledgeable defendant, N Enonchong [2000] Restitution L Rev 241, 250ff.

¹⁴⁴ *Strongman (1945) Ltd v Sincock* [1955] 2 QB 525, CA (the defendant refusing to pay for the claimant's building work because licence was not obtained for such work; the defendant, an architect, had undertaken to obtain such a licence; the main building contract was invalid because of unlicensed work; but the defendant's collateral assurance, that licence would be obtained, was enforceable and the claimant was able to recover payment for his work as damages for breach of that collateral warranty).

¹⁴⁵ The UK Law Commission has recently provided a detailed study of opportunities for restitution to avoid the defendant's unjust enrichment. See 'The Illegality Defence' (L Com CP No 189: 2009) Part 4, 65–85.

¹⁴⁶ *Bowmakers Ltd v Barnet Instruments Ltd* [1945] KB 65; considered in *Ma Ying v Chiu Hing Bui* [1966] HKDCLR 72; *Keung Chung Chuen v Tiger Balm Factory Also Known As Eng Aun Tong* [1953] 37 HKLR 186; [1953] HKCU 17; *Wing Fung Cheung Co Ltd v So Tao Chung T/A Cheong Tai Firm* [1961] DCLR 91; [1961] HKDCLR 91; [1961] HKCU 22; *Yung Yeung Shook Chun v Lau Pao Wing* [1964] 2 HKLR 460; [1964] HKCU 60; *Kwok Chung Ho v Wong Chuen Sang* [1969] HKLR 1; [1969] HKCU 2; *Sin Hua Enterprise Co Ltd v The Owners of the Motor Ship Harima* [1987] 4 HKLR 770; [1987] 1 HKC 397; [1987] 2 HKC 118; [1987] HKCU 195; *Johnson, Stokes & Master v Boucher, Trevor Ernest* [1989] 1 HKLR 219; [1989] HKCU 394; and *Chuang Yue Chien Eugene v Ho Yau Kwong Kevin* [2002] 4 HKC 245.

¹⁴⁷ *Singh v Ali* [1960] AC 167, 176, PC; *Belvoir Finance Co v Stapleton* [1971] 1 QB 210, CA. See also 'Recognition of Contractually Transferred, Created, or Retained Proprietary Rights', The UK Law Commission, 'The Illegality Defence' (L Com CP No 189: 2009) Part 5, 86–93.

¹⁴⁸ [1925] 2 KB 1.

¹⁴⁹ [1937] 2 KB 158, considered in *The Crown Agents For Overseas Governments and Administrations v Kow Yue Weaving Factory Ltd* [1957] 2 HKLR 285; [1957] HKCU 28.

for illegality. A party can recover money paid, or obtain recompense in respect of goods or services, where:

- (i) the party seeking restitution belongs to a class of persons intended to be protected by the relevant illegality rule;¹⁵⁰ or
- (ii) the claimant was induced to enter the contract by the defendant's misrepresentation of fact, or fraudulent misrepresentation of law¹⁵¹ (which might now extend to misrepresentations of law even if the misrepresentation was innocent),¹⁵² or
- (iii) the claimant has been induced to enter the contract by the defendant's application of duress;¹⁵³ or
- (iv) another opportunity for restitution arises in the face of certain decisions to resile from the unlawful project; the claimant (even though at first conscious of the illegality, and perhaps a main player in it) can obtain restitution if:
 - (a) the illegal scheme was voluntarily abandoned by him (that is, he did not abandon it only because he took fright or decided to mitigate his position once the illegality had been discovered by authorities or third parties)¹⁵⁴ and
 - (b) its purpose has not already been fully achieved;¹⁵⁵ but the Supreme Court of the United Kingdom has granted permission for a final appeal from the Court of Appeal's decision in *Patel v Mirza* (2014) concerning the scope of proposition (iv);¹⁵⁶

or

- (v) one he was ignorant of a *fact* which caused the transaction to be illegal;¹⁵⁷ but it is not clear whether there is a more general possibility of restitution based

¹⁵⁰ *Kiriri Cotton Co Ltd v Dewani* [1960] AC 192, 204, PC, *per* Lord Denning (payment of premium by tenant contrary to Ugandan regulations; but statute held to be intended to protect tenants); *Green v Portsmouth Stadium* [1953] 2 QB 190 (bookmaker, at defendant stadium's request, making unlawful payments to stadium; although denied access to stadium, unable to recover payments; statutory invalidity not aimed at protection of bookmakers but of the public at large).

¹⁵¹ *Brennan v Bolt Burdon* [2004] EWCA Civ 1017; [2005] QB 303; G H Treitel, *The Law of Contract*, edited by E Peel (13th edn, Sweet & Maxwell, 2011) 8-022ff; J Cartwright, *Misrepresentation, Mistake and Non-Disclosure* (2nd edn, 2007) 3.20; this decision allows rescission, etc, for misrepresentations of law (following *Kleinwort Benson Ltd v Lincoln CC* [1999] 1 AC 153, HL abolished the mistake of law bar to recovery of money paid by error); on the possible impact of this in the context of illegal contracts, 'The Illegality Defence' (L Com CP No 189: 2009) 4.15.

¹⁵² See preceding note on *Kleinwort Benson Ltd v Lincoln CC* [1999] 1 AC 153, HL, which abolished the mistake of law bar to recovery of money paid by error.

¹⁵³ *Smith v Cuff* (1817) 6 M & S 160, 165; 105 ER 1203, 1205 (Lord Ellenborough); cited in *Estinah v Holden Hand Indonesian Employment Agency* [2001] 4 HKC 607; *Davies v London and Provincial Marine Insurance Co* (1878) 8 Ch D 469, Fry J.

¹⁵⁴ *Tribe v Tribe* [1996] Ch 107, 135, CA, *per* Millett LJ; 'The Illegality Defence' (L Com CP No 189: 2009) 4.52.

¹⁵⁵ L Com CP No 189: 2009, 4.45ff, considering, notably, *Taylor v Bowers* (1876) 1 QBD 291, CA; *Kearley v Thomson* (1890) 24 QBD 291, CA; *Bigos v Boustead* [1951] 1 All ER 92, 97, Pritchard J; *Tribe v Tribe* [1996] Ch 107, CA.

¹⁵⁶ [2014] EWCA Civ 1047; [2015] Ch 271.

¹⁵⁷ *Oom v Bruce* (1810) 12 East 225, 226; 104 ER 87, 88 (insurance for cargo on ship proceeding to England from Russia; at the time of contract, the plaintiff insured had been unaware that war had recently arisen between these nations; on trading with the enemy, **13.15**).

on the claimant's innocence; thus it is uncertain¹⁵⁸ whether a mere mistake of law (that is, a mistake not induced by the defendant) will nowadays suffice; it has been contended that the English Court of Appeal's decision in *Mohamed v Alaga & Co* (2000)¹⁵⁹ might support this, at least where the defendant, a solicitor, is blameworthy in not appreciating that the contract was illegal, and the claimant cannot be expected to have known of a recondite point of illegality; this possibility requires clarification by the courts, but it appears that the law is inclining in this direction.

¹⁵⁸ *Hughes v Liverpool Victoria Friendly Society* [1916] 2 KB 482 (fraudulent misrepresentation of law; claimant able to recover premiums on illegal life insurance contract); cf *Harse v Pearl Life Assurance Co* [1904] 1 KB 558, CA (innocent misrepresentation of law not entitling claimant to recover premiums on illegal life insurance contract); cf now *Kleinwort Benson Ltd v Lincoln CC* [1999] 1 AC 153, HL—abolishing the mistake of law bar to recovery of money paid by error; on the possible impact of this in the context of illegal contracts, 'The Illegality Defence' (L Com CP No 189: 2009) 2.42.

¹⁵⁹ [2000] 1 WLR 190, CA: claimant performing (a) translation and (b) client introduction services for defendant solicitor; element (b) unlawful; whole contract for (a) and (b) invalid for illegality; but claimant awarded to a *quantum meruit* in respect of (a); N Enonchong [2000] Restitution L Rev 241 criticises this decision's reasoning, in so far as the claimant was awarded a *quantum meruit* for lawful services under (a); Enonchong says this indirectly gave effect to a contract tainted with illegality; Enonchong suggesting, *ibid* at 250ff, possible line of reasoning based on tortious duty of care owed by defendant; in cases where claimant is a solicitor who has performed services under an illegal contract, subsequent decisions have distinguished the *Mohamed* case (these decisions are considered in 'The Illegality Defence' (L Com CP No 189: 2009) 4.26ff): *Awwad v Geraghty* [2001] QB 570, 596, CA; and see the *dicta* in the *Dal Stirling Group* case [2002] TCLR 20.

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