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Contract Disputes Practical Guide

Introduction

In this guide, Calvin Lau, Founder of Ace Legal will consider the problems that can arise and some practical steps that can be taken to minimize the risks in disputes relating to commercial contracts under Hong Kong law.

“An oral contract, or one implied by conduct, is just as binding as a formal written agreement-but a lot less clear”

Top Tips to make sure you enter into contracts
Do remember a contract can be formed by e-mail or discussions or by conduct
Do mark all correspondence and drafts “subject to contract”
Don’t Start work until everyone has signed the dotted line
Do make sure all obligations are clearly defined.

What binds a contract?

1. A contract will be formed when the parties have agreed on its essential terms, though of course that basis analysis may involve many potential complications. In deciding whether a contract has been concluded, the court will look at the parties’ words and conduct overall and apply an objective test. Under Hong Kong law, there is no general requirement for particular formalities to be satisfied before a



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contract is formed; it is possible to make or accept an offer orally or by conduct, as well as in writing (though this general principle is subject to exceptions for certain types of contract, where formal requirements are imposed by statute, eg contracts for the sale of land).

2. For example, in *New World Development Co Ltd & Others and Sun Hung Kai Securities Ltd & Another* [2006] 3 HKLRD 345, the Court of Final Appeal decided that a multi-million dollar contract had been concluded during a telephone conversation. The Plaintiff had entered into a joint venture agreement to develop two hotels in Malaysia. The managing directors of the plaintiff and defendant, who were old friends and business associates, had conversations on the defendant's possible involvement in the hotel project. The two men orally agreed during a telephone conversation that the defendant would assume a stake in the plaintiff's share of the project. The defendant initially made several substantial contributions to the plaintiff in accordance with the oral agreement, but later stopped. The plaintiff commenced proceedings claiming more than \$80 million owned in contributions. The defendant attempted to argue, inter alia, that the oral agreement lacked certainty required of such a major and complex undertaking, but this was rejected by the court.

Formal Agreement Still to be executed

3. Parties may agree terms in discussions or correspondence with the intention that a formal document setting out the terms will be executed later. In these circumstances, it is often assumed that there is no binding agreement until that happens. That assumption may be misplaced. In fact the court will look at the parties' words and conduct to determine whether, judged objectively, they intended to be bound immediately or only when the formal document was executed.
4. The best way to avoid entering into binding commitments before you are ready is



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to ensure that all correspondence and draft documentation is clearly labelled “subject to contract”. That gives a strong indication that the parties do not intend to create a binding contract, though it is not conclusive. Other wording may have the same effect, for example “nothing is binding on the parties until the new agreement is signed”. However, references to recording the terms in a formal agreement may not always be effective.

Beginning Work Without Formal Agreement

5. Problems commonly arise where the parties agree terms “subject to contract” and then begin to perform the obligations envisaged without ever concluding the anticipated formal agreement.
6. It may then be unclear whether they have, in fact, concluded a contract on the terms set out in the pre-contractual documentation, or whether they have concluded a contract on some more limited terms, or whether there is no binding contract at all.
7. Although use of the “subject to contract” label (or equivalent wording) will normally prevent the creation of a binding agreement, as it indicates a lack of intention to create legal relations, it can be overridden by other circumstances. In particular, a court may find that the parties agreed to waive the “subject to contract” requirement, so that they would be bound despite the absence of a formal signed agreement. Such a waiver might be express or it might be inferred from the parties’ communications and conduct. The question of whether the parties intended to be bound, and by what terms, will all depend on the facts.

“If work has to start before full terms can be agreed, make sure you’ve got a clear interim agreement- and extend it as needed”.



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Incomplete or Uncertain Terms

8. Sometimes parties may intend to enter into a binding agreement, and believe they have done so, but a court may find that the parties' agreement is incomplete or is too uncertain to be enforced. As a result of this principle, Hong Kong law will not enforce a mere "agreement to agree". Such an obligation is too uncertain to form a binding contract: there is simply no way to determine what the parties are obliged to do.
9. In *Tam King Hang v Yuen Lei Gwun* HCA 490/2011, the court held that a chinese agreement entered into between the parties, under which the defendant agreed to sell her title in the property to the plaintiff once ongoing litigation over title in the property concluded and the defendant obtained titled in the property, was only an "agreement to agree" and not an immediately binding concluded agreement. This is because there was uncertainty in key terms; although the price was agreed on, no date or deadline was given for the conclusion of the litigation and when a formal sale and purchase agreement was to be signed.
10. That is not to say, however, that parties must agree every term of a proposed contract before they can be bound by it. In some cases the court may find that, judged objectively, the parties intended to enter into a binding contract even though some terms are left to be agreed.
11. Where that is the case, the contract will be enforceable so long as:
 - (a) They have agreed all essential terms, so that the failure to agree the remaining terms is not fatal ; or
 - (b) Where an essential term remains to be agreed, the court can "fill in" the missing term by implication.



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Promises on both sides

12. Unless it is by deed, an agreement will not be enforceable unless each party has provided “consideration” namely some form of payment or value. Commercial agreements normally involve obligations being taken on by each party, and so questions of a lack of consideration rarely comes up.

13. The law is not concerned with whether the amount of consideration offered is adequate by reference to the consideration received in return. Thus, if there is any doubt, parties should ensure that a token consideration is paid (e.g. HK\$1) or that the agreement is in the form of a deed so that no consideration is necessary.