Privy Council Appeal No. 47 of 1992

Take Harvest Limited *Appellant*

v.

(1) George H. Liu and
(2) Susan Parker Liu *Respondents*

(and Cross-appeal)

FROM

THE COURT OF APPEAL OF HONG KONG

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 9TH MARCH 1993

Present at the hearing:-

LORD KEITH OF KINKEL
LORD TEMPLEMAN
LORD JAUNCEY OF TULLICHETTLE
LORD BROWNE-WILKINSON
SIR CHRISTOPHER SLADE

*[Delivered by **Sir Christopher Slade**]*

This appeal and cross-appeal raise two principal issues. The first is whether an oral agreement to surrender a subsisting lease within a period not exceeding three years, which by section 3 of the Conveyancing and Property Ordinance (Cap. 219) of Hong Kong ("the Ordinance") is rendered unenforceable, should be held to operate as an agreement to create a new lease taking effect in possession for a term enduring for a corresponding period, and whether or not there is evidence that the parties intended to create such a new lease. The second concerns the impact of section 3 in a case where one of the parties to the oral agreement to surrender asserts that it is relying on such agreement solely by way of defence.

The relevant premises ("the premises") comprise the Second Floor of Wilfred Apartment at 110 Repulse Bay Road, Hong Kong. They originally belonged to a company controlled by the plaintiffs in these proceedings, George Liu and his wife Susan Liu ("the tenants"), but were subsequently sold to the defendant Take Harvest Limited ("the landlord") subject to a leaseback of the premises to the tenants. The leaseback was effected by a tenancy agreement of 29th October 1990, which provided for the
[9] grant of a term of one year from 18th October 1990 at a

monthly rent of HK$55,000 and entitled the landlord to terminate the tenancy by one month's prior notice in writing. Clause 5(a) of the second schedule provided for the tenants to pay to the landlord a deposit of HK$110,000 as security for the observance of the tenants' covenants and entitled the landlord to retain it for his own benefit throughout the term with power "to deduct therefrom the amount of any rent or other charges payable hereunder which is in arrear". Clause 5(b) provided that subject as aforesaid the deposit should be refunded to the tenants by the landlord within 15 days after the later to occur of two specified contingencies, the relevant contingency for present purposes being "the expiration or sooner determination of this Agreement and the delivery of vacant possession of the Premises ... to the Landlord ...".

The deposit was duly paid and the tenancy agreement was suitably endorsed on behalf of the Commissioner of Rating and Valuation, with the result that it fell outside Part IV of the Landlord and Tenant (Consolidation) Ordinance (Cap. 7), which requires a landlord to give his tenant notice (of a specified length) of termination of his tenancy and gives the tenant the right to apply to the Lands Tribunal for the grant of a new tenancy. The tenants had always been on very amicable terms with Henry Lau, a director of the landlord. They had agreed to take a leaseback of the premises so as to keep them tenanted while Mr. Lau looked for a suitable tenant. Although the agreement provided for a term of one year, they were prepared to move out on short notice.

On 9th November 1990, eleven days after the signing of the tenancy agreement, Mr. Lau informed Mr. Liu in a telephone conversation that he had a prospective tenant for the premises and enquired when the tenants could move out. Though there was a conflict of evidence on this important point, the trial judge, His Honour Deputy Judge Bharwaney, found that Mr. Liu telephoned and spoke to Mr. Lau a second time on 9th November, that, when he made that second call, he offered to move out by the end of the month and that "Henry Lau, on behalf of Take Harvest, accepted that offer and invited the Lius to move out earlier, if possible". The trial judge further found that "Henry Lau did not take care to express a rider to the effect that the matter was subject to confirmation or words to that effect" and that, though Mr. Lau believed that he had not reached any agreement with Mr. Liu regarding the termination of the tenancy agreement by the end of November 1990, "a binding agreement was reached in this case". Subject to the operation of section 3 of the Ordinance, this finding has not been challenged on this appeal.

The tenants, with the assistance of Mr. Lau, who had experience in the real estate business, then sought alternative accommodation for themselves. Mr. Lau himself was also occupied in attempting to conclude arrangements with a prospective tenant of the premises. The events and discussions between the parties between 9th November and

10th December 1990 are recited in detail in the trial judge's careful judgment. In this context for present purposes it will suffice to mention only a few of them. On 13th November the tenants arranged, subject to contract, to take a lease of an apartment in Kennedy Road, Hong Kong. By 15th November, however, the prospective tenant had decided not to take a lease of the premises in Wilfred Apartment. On that day Mr. Lau requested Mr. Liu to delay the commencement of the Kennedy Road lease or to cancel it altogether and offered to pay the legal costs involved. At the trial, the tenants did not plead or rely on any estoppel. The trial judge, however, said:-

> "... if it had been contended that the statements made by Henry Lau on the 9th November, 1990 gave rise to an estoppel against Take Harvest, I would have found, given the fact that the Lius were not legally bound to take up the lease of the Kennedy Road apartment, that Henry Lau's offer, on the 15th November, 1990, to shoulder wasted legal costs, would have removed any detriment that could have been suffered by the Lius, and would have enabled Take Harvest to revert to the strict legal position pertaining on the 9th November, 1990, before the creation of any estoppel against it, whether of the promissory variety or of the classic type, arising out of representations made by Henry Lau, on behalf of Take Harvest, on that day."

The tenants did not commit themselves in response to Mr. Lau's request. Over the succeeding days, the parties had a number of conversations, the tenor of which showed Mr. Lau's attitude changing from a polite request to the tenants to delay moving out to his firm insistence that they could not do so until a new tenant had entered into a binding agreement to take up the premises. On 23rd November 1990 Mr. Liu sent to him a facsimile message stating that the tenants could not delay their move beyond 10th December 1990. Mr. Lau replied contending that they were not entitled to do this. The trial judge accepted that the date 10th December originated from the tenants and that Mr. Lau had never agreed to that particular day as the day on which they could vacate the premises. On 29th November 1990 Mrs. Liu signed the tenancy agreement for the Kennedy Road apartment. On 7th December Mr. Liu and Mr. Lau had a meeting at which, as the trial judge found:-

> "George Liu informed Henry Lau that the Lius were moving out on the 10th, like it or not. Henry Lau refused to accept the keys and insisted that it was wrong of them to move out."

On 10th December 1990 the tenants moved out of the premises. On that day Mr. Liu called Mr. Lau and asked him what he should do with the keys. Mr. Lau told him that he was not accepting a surrender and suggested that the best thing for both of them would be if he left the keys with the tenant of the first floor premises which

were also owned by the landlord. This was done the next day.

On 11th December 1990 Mr. Liu sent to Mr. Lau a facsimile message in which he said:-

> "... I am right now relinquishing the premises to you and would like to ask you to refund our deposit of $110,000 proportional to the date that we have vacated the premises."

The tenants had paid rent up to 17th November 1990 but not thereafter. The landlord declined to repay the deposit and for its part claimed repayment of outstanding rent. Though, according to the findings of the trial judge, the parties had entered into a contract under which the tenants agreed to surrender their lease on or before 30th November and the landlord had agreed to accept such surrender, the tenants, with the consent of the landlord, had continued in occupation of the premises until 10th December. They were plainly liable for rent at least up to that date, if not beyond it (as the landlord has at all times contended). The outstanding rent for the period from 18th November to 10th December 1990 amounted to HK$42,167. On 11th February 1991 the landlord reentered the premises in purported exercise of a right of re-entry conferred by the tenancy agreement.

On 26th February 1991 the tenants instituted proceedings in the District Court of Hong Kong claiming the return of HK$67,833 (representing their deposit of HK$110,000 less HK$42,167) plus interest. In their particulars of claim, to justify their claim to such repayment, they pleaded the relevant provisions of the tenancy agreement (including clauses 5(a) and 5(b) of the second schedule) and the payment of the deposit and alleged:-

> "(5) On or about 9th November 1990 a Mr. Henry Lau of the Defendant called to George H. Liu of the Plaintiffs asking the Plaintiffs to terminate the Tenancy Agreement by delivering vacant possession of the Premises to the Defendant as soon as possible because the Defendant had found a tenant who was willing to take up the Premises.
>
> (6) At a later time on the 9th November 1990, George H. Liu of the Plaintiffs accepted the Defendant's proposal to terminate the Tenancy Agreement and vacate the Premises by the end of November 1990. It was further agreed that the rental for the period from 18th November 1990 to the date of delivery of vacant possession should be deducted from the Deposit."

They further alleged:-

> "(13) Pursuant to the agreement made on the 9th November 1990, the Plaintiffs had vacated the Premises on 10th December 1990 and on the 11th December 1990 delivered the key to the domestic helper in the 1st Floor of Wilfred Apartment as suggested by Henry Lau of the Defendant."

Section 3 of the Ordinance, (which is in similar terms to section 40 of the Law of Property Act 1925 of England, replacing part of section 4 of the Statute of Frauds 1677) provides:-

"3. Land contracts to be in writing

(1) Subject to section 6(2), no action shall be brought upon any contract for the sale or other disposition of land unless the agreement upon which such action is brought, or some memorandum or note thereof, is in writing and signed by the party to be charged or by some other person lawfully authorized by him for that purpose.

(2) This section applies to contracts or other dispositions whenever made and does not affect the law relating to part performance ..."

Section 4 provides:-

"4. Legal estate to be disposed of etc. by deed

(1) A legal estate in land may be created, extinguished or disposed of only by deed.

(2) This section does not apply to -

...

(c) a surrender by operation of law, including a surrender which may, by law, be effected without writing;

(d) the grant, disposal or surrender of a lease taking effect in possession for a term not exceeding 3 years (whether or not the lessee is given power to extend the term) at the best rent which can be reasonably obtained without a premium;

..."

Section 6 provides:-

"6. Creation of interest in land by parol

(1) All interests in land created by parol and not put in writing and signed by the persons creating the same, or by their agents thereunto lawfully authorized in writing, have, notwithstanding any consideration having been given for the same, the force and effect of interests at will only.

(2) Nothing in section 3 or 5 or in subsection (1) shall affect the creation by parol of leases taking effect in possession for a term not exceeding 3 years

(whether or not the lessee is given power to extend the term) at the best rent which can be reasonably obtained without a premium."

It is clear (and now common ground) that

(a) the contract alleged in paragraphs (5) and (6) of the particulars of claim would constitute "a contract for the disposition of land" within the meaning of section 3 of the Ordinance;

(b) a defence based on section 3 (like any defence based on section 40 of the Law of Property Act 1925 in England) has to be specially pleaded, if it is to be relied on at a trial in the courts of Hong Kong.

No reference to section 3, however, was made in the formal defence to the action filed on behalf of the landlord. The defence and counterclaim denied the oral agreement alleged to have been concluded on 9th November 1990 and any liability to the tenants. It asserted that the tenancy agreement had come to an end on 11th February 1991 by the landlord's reentry, and claimed arrears of rent at the rate of HK$55,000 per month from 18th November 1990 to 11th February 1991 and a declaration that the landlord was entitled to forfeit the deposit. A reply and defence to counterclaim filed by the tenants raised no plea of estoppel based on the oral agreement of 9th November 1990. However, it repeated paragraphs 5 to 15 of the particulars of claim and thus reasserted that oral agreement.

At the trial, counsel for the landlord did not pursue its claim to forfeit the deposit and limited its counterclaim to HK$44,354.80, being the arrears of rent calculated up to 11th February 1991 less the amount of the deposit.

The relevant findings of fact made by the trial judge have been summarised above. On the basis of these findings, he reached (in summary) the following conclusions of law:

(a) Since the oral agreement of 9th November 1990 providing for the determination of the tenancy agreement and the surrender of the remainder of the term was not reduced to writing, the tenants, in order to resist the landlord's claim for rent, had to persuade him that there had been a surrender by operation of law, (which by section 4(2)(c) of the Ordinance is exempted from the requirement in section 4(1) that a term of years may be disposed of only by deed).

(b) There was no surrender by operation of law arising from any conduct of Mr. Lau amounting to an acceptance of possession by the landlord prior to 11th February 1991 or raising an estoppel against the landlord.

(c) However, the oral agreement of 9th November 1990 was binding and effective to create a new tenancy for a term from 9th November to 30th November 1990.

(d) This new tenancy was exempted from the requirement of writing by section 6(2) of the Ordinance.

(e) The new tenancy was inconsistent with the continuation of the former tenancy and accordingly the former tenancy was surrendered by operation of law.

(f) The new tenancy was continued beyond 30th November 1990 by section 117 of the Landlord and Tenant (Consolidation) Ordinance (Cap. 7).

(g) The new tenancy was determined on 10th January 1991 by one month's notice given in accordance with section 119B(2) of the latter Ordinance by Mr. Liu's facsimile message dated 11th December 1990, so that the tenants' obligation to pay rent ceased on 10th January 1991.

In the light of these conclusions the trial judge in his judgment of 15th January 1992 held that the tenants were entitled to the repayment of HK$12,833.00 representing the balance of the deposit after deduction of rent for the period from 18th November 1990 to 10th January 1991 plus interest. He dismissed the counterclaim and made an order nisi as to costs, on both the claim and the counterclaim, in favour of the tenants.

On 11th February 1992 the trial judge heard an application by the landlord (a) for leave to amend the defence and counterclaim so as to plead *(inter alia)* section 3 of the Ordinance; (b) to review his decision on the grounds that the agreement of 9th November 1990 did not have the effect of creating an oral tenancy for a term expiring on 30th November 1990.

The trial judge dismissed the application with costs but gave the landlord leave to appeal from his judgment of 15th January 1992. With this leave, the landlord appealed to the Court of Appeal of Hong Kong, which by an order of 10th April 1992 allowed the appeal. Neither party sought to disturb the trial judge's findings of fact. By its notice of appeal, however, the landlord challenged the finding of surrender by operation of law while, by their respondents' notice, the tenants sought to support the trial judge on grounds of estoppel in relation to which, though not pleaded, he had made a finding adverse to them. As to estoppel the court found it unnecessary to express an opinion. Kempster JA. pointed out that, contrary to the trial judge's view, section 6(2) of the Ordinance could not be prayed in aid in relation to the new parol lease held to have come into existence since it

did not provide for the best rent which could reasonably be obtained without a premium. He continued:-

> "It would therefore be unenforceable but, being nonetheless valid, effective to work a surrender of the existing written lease by operation of law if the intention of the parties could not otherwise be implemented. There was no other way. In the absence of writing, the existing lease could not be varied and an agreement to surrender it on 30 November could not be enforced. On this somewhat laconic basis I would affirm the judge's finding on the law in relation to surrender."

Sir Derek Cons. V.-P. and Penlington JA. agreed with this conclusion. However during the course of the argument, the court had questioned the correctness of the trial judge's conclusion that the facsimile letter of 11th December 1990 constituted a sufficient notice to comply with section 119B(2) of the Landlord and Tenant (Consolidation) Ordinance. Though given the opportunity to do so, counsel for the landlord did not seek to amend his notice of appeal to argue this point. In giving judgment, the court unanimously held that the facsimile letter of 11th December 1990 did not constitute such sufficient notice and that the tenants accordingly remained liable for rent up to 11th February 1991 when the landlord reentered. In the result the court, by its order of 10th April 1992, allowed the appeal, set aside the trial judge's judgment and ordered that judgment be entered for the landlord in the sum of HK$44,354.80. However, inasmuch as the landlord had succeeded on a point which had not been taken in the notice of appeal - and indeed which the landlord's counsel had expressly declined to take - the court ordered that the landlord should pay to the tenants three-quarters of the costs of the appeal and their full costs in the court below.

Subsequently the landlord applied to the Court of Appeal for leave to appeal to Her Majesty in Council from that part of its order which related to costs, primarily on the grounds that the court had erred in upholding the finding of the trial judge that on the facts as found there was a surrender by operation of law. On giving leave, the Court of Appeal recognised that the point was one of importance in the context of Hong Kong, where most interests in land are of a leasehold nature. The tenants then sought and obtained leave to cross-appeal, with the object of establishing that their liability for rent terminated on a date earlier than 11th February 1991.

Did the oral agreement of 9th November 1990 give rise to a new tenancy?

In *Jenkin R. Lewis & Son Ltd. v. Kerman* [1971] Ch. 477 at page 496, Russell L.J., delivering the judgment of the Court of Appeal, summarised a set of circumstances in which, on well-established principles, a lease will be treated as having been surrendered by operation of law:-

> "If a tenant holding land under a lease accepts a new lease of the same land from his landlord he is taken to have surrendered his original lease immediately before he accepts the new one. The landlord had no power to grant the new lease except on the footing that the old lease is surrendered and the tenant by accepting the new lease is estopped from denying the surrender of the old one. This 'surrender by operation of law' takes effect whether or not the parties to the new lease intend it to take effect. Moreover, even if there is no express grant of a new lease the old lease will be surrendered by operation of law if the arrangements made between the landlord and the tenant are such as can only be carried out so as to achieve the result which they have in mind if a new tenancy is in fact created."

On the facts of that case, however, the court held that an agreement between a landlord and tenant for an increase in the rent did not result in a surrender of the existing tenancy and the creation of a new tenancy. As Russell L.J. observed (at page 496H):-

> "Viewing the matter apart from authority it is difficult to see why the fiction of a new lease and a surrender by operation of law should be necessary in this case; for by simply increasing the amount of the rent and providing that the additional rent shall be annexed to the reversion, one is not altering the nature of the pre-existing item of property."

The trial judge, in giving judgment on the landlord's application for review, having cited in full the first of these two passages from Russell L.J.'s judgment, said:-

> "The present case falls within the latter category. If my conclusion that there was a grant of an oral tenancy is no more than a legal fiction, or, to borrow from the same judgment of Russell L.J. (at page 496H) 'the fiction of a new lease', then so be it - I have reached that conclusion in order to give effect to the oral agreement reached between the parties on the 9th November 1990".

In his original judgment, he had cited the decision in *Fenner v. Blake* [1900] 1 Q.B. 426 as authority for the proposition that "although an oral agreement to surrender a lease is per se ineffective, it may nevertheless bring about a surrender by operation of law".

In the Court of Appeal, Kempster JA., who delivered the leading judgment, made a passing reference to *Fenner v. Blake*. However both he and Sir Derek Cons V.-P. principally relied on the judgment of Russell L.J. in *Jenkin R. Lewis & Son Ltd. v. Kerman (supra)* as authority for the proposition that in the present case the oral agreement to surrender the subsisting tenancy gave rise to a new tenancy.

With respect to both courts below, their Lordships consider that this conclusion involved a misinterpretation of Russell L.J.'s judgment and a misunderstanding of the relevant law. The substantial result which the landlord and tenant "have in mind" in making their arrangements in the hypothetical case postulated by Russell L.J. is that the tenant shall have a new tenancy of the premises on different terms from those of his former tenancy, whether or not they realise that the law would analyse their agreement as having the effect of the grant of a new tenancy and a surrender of the former tenancy. In cases where the parties do not have this substantial result in mind, the grant of a new tenancy (with a consequent surrender by operation of law) will not be inferred. This is made additionally clear by the illustrations given by Russell L.J. by way of example at page 496D-F of the report.

In the present case there was no evidence whatever that, in reaching the agreement of 9th November 1990, the parties ever thought of or contemplated a new 21 day tenancy. On the trial judge's findings, they were intending to do no more than agree a surrender of the subsisting tenancy. The courts below appear to have considered that, because section 3 of the Ordinance rendered such agreement unenforceable, they were obliged or entitled to invoke the fiction of a new tenancy, because this was the only way to give legal effect to the agreement for a surrender. Their Lordships consider this conclusion to be contrary to principle and authority.

In *Sidebotham v. Holland* [1895] 1 Q.B. 378, the plaintiff agreed to let a house to the defendant on a yearly tenancy, beginning on 19th May 1890. In late 1893 the plaintiff gave the tenant notice to quit on 19th May 1894 and subsequently brought an action to recover possession of the house. The defendant disputed the validity of the notice to quit and also set up an alleged oral agreement made in December 1892 that the tenancy should not be terminated till November 1895. The Court of Appeal rejected both defences. As to the alleged promise by the landlord not to turn the tenant out, Lindley L.J., giving the reserved judgment of himself and Lord Halsbury, said this (at page 385):-

> "Unfortunately, however, the promise was a verbal one; it was not to be performed within a year, and the Statute of Frauds precludes the defendant from enforcing it. Under these circumstances it is impossible to hold the notice bad on this ground. An argument was advanced that this verbal agreement created a new lease until November, 1895, and that the term created by the written agreement of 1890 was impliedly surrendered. But it is familiar law that whether an agreement operates as a demise or as an agreement only depends on the intention of the parties. Now, in this case it is plain that no new lease was ever thought of or intended by either party, and it would not be right to invent one in order to get the defendant out of the difficulty in which the absence of a written agreement places her."

Their Lordships accept the landlord's submission that this passage, *mutatis mutandis*, is directly applicable in the present case. It would not be right to invent a fictitious new tenancy supposed to have subsisted from 9th November to 30th November 1990, simply in order to avoid the consequences of the agreement for surrender made on 9th November 1990 having failed to comply with the requirements of writing contained in section 3 of the Ordinance.

Finally in the context of this point of law brief reference should be made to *Fenner v. Blake (supra)* on which both courts below placed some reliance. On the facts of that case the Divisional Court held that an action for ejectment against a tenant by a landlord under a yearly tenancy was maintainable on the grounds (*inter alia*) that an oral agreement to surrender a tenancy, though ineffective as an agreement to surrender because of the Statute of Frauds, amounted to the grant and acceptance of a new tenancy, and that the acceptance of the new tenancy caused a surrender of the old one. The extempore judgments of Channell J. and Bucknill J. were very short and the findings of fact, if any, made by the County Court judge as to the parties' intentions are not clear from the report. On the facts as reported, however, it would seem that no intention in the parties to create a new tenancy could properly have been inferred and that, insofar as the Divisional Court implied the grant and acceptance of a new tenancy, its decision was therefore probably erroneous (though it may have been justified on the alternative stated ground of estoppel).

In the event, before this Board Mr. Lightman Q.C., on behalf of the tenants, did not seek to dispute the contention of Mr. Nugee Q.C., on behalf of the landlord, that the oral agreement of 9th November 1990 gave rise to no new tenancy. It is thus common ground that an essential link in the reasoning which led both courts below to their ultimate (albeit different) conclusions was erroneous, as their Lordships now conclude. The consequences are far-reaching; the case must now be looked at entirely afresh.

The essential facts, however, can now be restated very shortly. On 9th November 1990 the parties orally agreed that the tenants should surrender their tenancy on or before 30th November 1990 and that the landlord should accept the surrender. A term of this agreement, by necessary implication, was that the tenants should not be charged rent in respect of a period after they had surrendered the tenancy in accordance with the agreement. Mr. Liu's evidence, which the trial judge appears to have accepted, was that on 9th November Mr. Lau had expressly suggested that the rental for the period before the vacation of the premises should be deducted from the deposit. In the event the tenants continued in occupation of the premises until 10th December 1990, but this was with the consent, indeed at

the request, of the landlord; it has not been suggested that this involved a repudiation by the tenants of the oral agreement. On 10th December 1990 the tenants vacated the premises as they were entitled to do. Though the landlord would not accept the attempted surrender of the tenancy by the tenants, they did all that was in their power to restore possession of the premises to the landlord. Save to the extent that, by mutual agreement of the parties, the tenants continued in occupation of the premises for ten days after 30th November 1990, there are no grounds for supposing that the oral agreement of 9th November 1990 was subsequently either varied or rescinded; no such rescission or further variation was pleaded or proved in evidence.

In these circumstances, if full force is to be given to that oral agreement, but subject to the impact of section 3 of the Ordinance, their Lordships regard it as plain that the tenants would be liable for rent up to, but not beyond, 10th December 1990. This leaves for consideration the crucially important question of the impact of section 3.

The impact of section 3 of the Ordinance

As stated above, the landlord in its defence to the tenants' action did not plead section 3 and its application to the trial judge for leave to amend the pleading after judgment was refused. No application for leave to amend was made to the Court of Appeal. Against this background, at an early stage of the hearing before this Board, Mr. Nugee, for the landlord, applied for leave to rely on section 3. This application was strongly opposed by Mr. Lightman, for the tenants, who submitted that it was far too late for the landlord to invoke the section. On grounds which will be explained hereafter, Mr. Lightman further informed the Board that he would seek to argue that section 3 could not in any event afford a defence to the landlord against the tenants' claim to repayment of part of the deposit. If, however, the Board did not accept that submission but were to permit the landlord to rely on section 3, he submitted that justice would require that the case be remitted to the District Court of Hong Kong, so that the tenants should be given the opportunity to plead and argue that there had been part performance of the oral agreement of 9th November 1990, so as to render section 3 inapplicable, and/or that, since the tenants had acted in reliance on the agreement, the landlord was estopped from seeking to enforce the provisions for payment of rent in respect of a period after 10th December 1990, when the tenants vacated the premises.

Their Lordships consider that the landlord's failure to plead section 3 was a substantial cause of the wrong course taken by these proceedings until they reached this Board. On the other hand, so also were the tenants' failure to plead estoppel and their reliance on *Fenner v. Blake*, a decision which in their Lordships' view led the lower courts to misdirect themselves in law. In the very exceptional circumstances of this case, their Lordships thought it

right, in the exercise of their discretion, to accede to the application made by the landlord's counsel for leave to rely on section 3, while at the same time permitting the tenants' counsel by way of response to advance and develop the arguments summarised above.

The next question therefore is whether section 3 of the Ordinance can in law afford any assistance to the landlord on the facts of the present case. Mr. Lightman submitted that an oral agreement which is unenforceable because of that section (or section 40 of the English Law of Property Act 1925) is (a) nonetheless valid and binding; (b) available as a defence in the same way and to the same extent as any enforceable contract. In the present case, he submitted, the tenants' claim was not an action to enforce the oral agreement because they were suing for return of the balance of the deposit under clause 5 of the second schedule to the tenancy agreement and relying on the oral agreement solely by way of defence to counterclaim.

Their Lordships have been referred to a number of authorities relating to the legal effects of the absence of writing in cases where section 40 of the English Law of Property Act 1925 or equivalent sections have rendered an oral contract unenforceable. "It must be remembered that this legislation did not and does not make oral contracts relating to land void; it only makes them unenforceable" (*Steadman v. Steadman* [1976] A.C. 536 at page 540 per Lord Reid). Furthermore, as Viscount Dilhorne pointed out in the same case (at page 551), while section 40 of the Law of Property Act 1925 and section 4 of the Statute of Frauds both prohibit the bringing of an action on such a contract, neither Act explicitly prohibits it being relied on in defence. There is authority for the proposition that a contract not complying with the Statute of Frauds can still give rise to a good defence to a claim by the other contracting party to recover money paid in pursuance of it. See *Thomas v. Brown* (1876) 1 Q.B.D. 714. Their Lordships are disposed to think that Gavan Duffy C.J., Starke J. and McTiernan J. in their joint judgment in the High Court of Australia in *Perpetual Executors and Trustees Association of Australia Ltd. v. Russell* (1931) 45 C.L.R. 146 went a little too far in saying (at page 153) that "neither at law nor in equity can a claim unenforceable by action because of the Statute be enforced by counterclaim or defence" [emphasis added]. Reference in this context may be made to a learned article by Professor James Williams appearing in (1934) 50 L.Q.R. 532.

Nevertheless, as Evatt J. pointed out in the latter case (at page 157), if in any such situation it were open to a party by way of pleaded defence to set up and prove an oral agreement, much of the mischief which the statutory provisions were designed to avoid would continue. The courts have therefore been rightly very cautious before acceding to a submission that a party seeking to rely on

an oral agreement is seeking to invoke the oral agreement as a shield rather than a sword - in other words is not seeking to enforce the agreement: see for example *Delaney v. T.P. Smith Ltd.* [1946] K.B. 393 and *McDonald v. Windaybank* (1975) 120 Sol.Jo. 96 where such a submission was advanced but rejected.

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

In the present proceedings their Lordships are satisfied that the tenants must be regarded as seeking in substance to enforce the oral agreement of 9th November 1990. The point may be tested in this manner. *Prima facie* clause 5(b) of the second schedule to the tenancy agreement governed the tenants' right to repayment of their deposit. *Prima facie*, when the tenants sought the return of the balance of their deposit after 10th December 1990, none of the contingencies specified in clause 5(b), which would entitle them to the return of this balance, had yet occurred. They were therefore obliged to rely on the oral agreement of 9th November 1990 for the purpose of justifying their claim to repayment and indeed did rely on it in paragraphs (5), (6) and (13) of their particulars of claim. In these circumstances, it is clear that they were seeking to enforce the oral agreement at least insofar as they sought return of their deposit (less the rent due up to 10th December 1990).

But then, it is submitted, when the landlord subsequently counterclaimed for rent in respect of a period after 10th December and the tenants relied on the oral agreement by way of defence to this counterclaim, the tenants were not seeking to enforce the oral agreement. This submission cannot be accepted. If regard is confined to the only relevant written document (the tenancy agreement), the landlord was in the events which happened entitled to receive rent up to February 1991. In order to meet that claim, the tenants were obliged to ask and (in their reply and defence to counterclaim) did ask the court to give effect to their rights under the oral agreement. Thus, once again, they were seeking in substance to enforce that agreement, within the meaning of section 3 of the Ordinance.

The situation in the present case is different from that in *Thomas v. Brown (supra)*. In that case the purchaser of

land paid to the vendor a deposit on account of the purchase money. Later she decided not to proceed with the purchase and brought an action to recover the deposit as on a failure of consideration, contending that the contract did not comply with the statute and hence could not be relied on by the defendant to justify the retention of the money. Though the court's expressed grounds for rejecting this unmeritorious claim are not perhaps entirely clear, the decision may well be justifiable for reasons which can be gleaned from Professor Williams' article mentioned above. Though the contract was not enforceable, it was not a nullity and there was nothing in the statute to prevent any court which might have to exercise jurisdiction in the matter from inquiring into and taking notice of the truth of the facts. Those facts would presumably have shown that the property in the money paid by way of deposit had passed to the vendor. Accordingly, in resisting the purchaser's claim, the vendor was not seeking in substance to enforce the oral contract; he was merely asking the court to recognise the title to the money which he had already acquired by virtue of the valid, though unenforceable, contract.

The only cited authority which appeared to give direct support to the tenants' submissions in this context was a decision of first instance, *Couvell v. Hodkisson* (1961) 179 E.G. 497. The facts of that case bore at least a superficial similarity to those of the present case insofar as the plaintiff landlord, despite the existence of a prior oral agreement for the surrender of the lease, was seeking to recover rent in respect of a period after the agreed date of surrender. Buckley J. dismissed the claim. In the course of his judgment, as reported, he said:-

> "Here the first defendant was not seeking to bring an action on this contract. He was seeking to use it as a weapon of defence, as, in his (Buckley J.'s) judgment, he was entitled to do, notwithstanding the absence of a written memorandum, and the plaintiff could not use the absence of a memorandum to cloak or justify her own breach of the agreement."

Their Lordships have some doubts as to the correctness of this part of Buckley J.'s decision. The case, however, is only very briefly reported and there may be material distinctions from this case on the facts. In particular it is to be observed that the proceedings in that case were not initiated by a claim on the tenants' part founded on the oral agreement.

For the reasons stated, their Lordships conclude that, subject to the possible operation of the doctrines of part performance and/or estoppel, section 3 of the Ordinance must deprive the tenants of the right to rely on the oral agreement for the purpose of defeating the landlord's claim for rent up to 11th February 1991.

Part Performance and Estoppel.

In response to the tenants' invitation to the Board to give them the opportunity to rely on the doctrine of estoppel, Mr. Nugee drew attention to the fact that the point was not pleaded and that, though it was dealt with briefly (and rejected) by the trial judge, it was not argued before him. He submitted that, if the point had been pleaded or raised at the trial, its resolution might have necessitated a good deal of further evidence as to the background of the matter and the relationship between the parties. In his submission, in accordance with the practice of the Board illustrated by such cases as *United Marketing Co. v. Kara* [1963] 1 W.L.R. 523, the tenants should not be allowed to raise and argue this point for the first time in the Privy Council.

As to part performance, Mr. Nugee in the course of argument accepted that rather different considerations applied. He accepted that if the landlord were given leave to pursue the point based on section 3, which had not been pleaded and argued at the trial, it could not be right to preclude the tenants from pursuing, in direct response to that point, such arguments as might be available to them based on the principle of part performance. He submitted, however, that the principle could be of no avail to the tenants, on the simple ground that it can never apply to a contract for the surrender of a lease. If acts are to qualify as acts of part performance, he submitted, they must be in furtherance of the relevant contract, and not merely by way of recognition of its existence: (see *Elsden v. Pick* [1980] 1 W.L.R. 898 at page 905 per Shaw L.J.). If a tenant merely vacates the premises without the landlord retaking possession of them, this, it was submitted, cannot constitute part performance in the relevant sense.

The decision of the House of Lords in *Steadman v. Steadman* [1976] A.C. 536 shows that alleged acts of part performance have to be considered in their surrounding circumstances and must at the very least point, on the balance of probabilities, to the existence of a contract. The mere vacation by a tenant of the tenanted property cannot, by itself and without more, constitute an act of part performance because viewed in isolation it is equally consistent with the existence or non-existence of a contract to surrender the tenancy. Their Lordships, however, are not persuaded that on the facts of the present case the tenants would necessarily fail in establishing part performance of the oral agreement of 9th November 1990, in one way or another, if they were given the opportunity to plead and argue it and support it by appropriate evidence at a new hearing. They consider that in fairness the tenants should be given such opportunity to rebut the landlord's newly advanced plea based on section 3 of the Ordinance at a remitted hearing in the District Court of Hong Kong.

Much the same considerations apply to the question of estoppel. The tenants' position in this context is perhaps somewhat weaker, in that they could reasonably have been expected to plead and rely on estoppel in the District Court, even though section 3 had not been pleaded by the landlord. However, the only reason why the tenants now seek to rely on estoppel is that the landlord has been given by this Board the great indulgence of permission to rely on section 3 at this very late stage. Their Lordships consider that in all the circumstances indulgence should in justice similarly be shown to the tenants in relation to estoppel and that they should be given the opportunity to plead and argue it and support it, so far as they are able, by appropriate evidence at the remitted hearing.

Costs.

Regrettably, due to errors on both sides, these proceedings have taken a wrong course more or less from the beginning and even now cannot be finally disposed of by this Board. Their Lordships consider that the responsibility for these errors cannot fairly be attributed more to one party than the other and that as yet it cannot be said that one side, rather than the other, has emerged the victor. In all the circumstances, notwithstanding submissions to the contrary by counsel on both sides, their Lordships consider that the fair order to make in regard to costs is that each party shall pay its own costs both of the trial before the trial judge, the application to review his decision and of the hearings before the Court of Appeal and this Board. The costs of the remitted hearing will of course fall to be dealt with by the District Court of Hong Kong.

Conclusion.

Their Lordships, who are indebted to counsel on both sides for their admirable arguments, will therefore humbly advise Her Majesty that:-

(1) the landlord's appeal and the tenants' cross-appeal should each be allowed in part;

(2) the orders of the trial judge and of the Court of Appeal should be set aside;

(3) the landlord should have leave to amend its defence and counterclaim so as to plead section 3 of the Ordinance;

(4) the tenants should have leave to amend their reply and defence to counterclaim so as to plead part performance and estoppel;

(5) the case should be remitted to the District Court of Hong Kong finally to adjudicate on the parties' respective rights, having regard to this Board's

judgment and the amended pleadings and any further evidence adduced by the respective parties in support or rebuttal of the pleas of part performance and estoppel; and

(6) each party should pay its own costs both of the trial before the trial judge, the application to review his decision and of the hearings before the Court of Appeal and their Lordships' Board.