is what the parties *wrote*. Indeed, this point was re-emphasised by Lord Hoffmann sitting as a Non-Permanent Judge in the Court of Final Appeal case of *Jumbo King Ltd v Faithful Properties Ltd*:

> The construction of a document is not a game with words. It is an attempt to discover what a reasonable person would have understood the parties to mean.[6]

**1.4** Further, and more recently, Ribeiro PJ in the Court of Final Appeal case of *Champion Concord Ltd v Lau Koon Foo* – citing with approval Lord Hoffmann's statement in *Chartbrook Ltd v Persimmon Homes Ltd*[7] – emphasised that:

> … the Court's task is to determine 'what a reasonable person would have understood the parties to have meant by using the language which they did'.[8]

## 2. Are the Parties' Intentions Relevant At All?

**1.5** Although the subjective intention of the parties is irrelevant, the *objective manifestation* of their intention is relevant: what the court is ultimately trying to do is find out what the parties meant, even though it will not consider their subjective intentions.[9] Just as the civil law courts do, the court is trying to ascertain the parties' intentions, albeit the common law courts do it via an *objective* assessment.

**1.6** Nevertheless, this is not to say that establishing such intention is never fictional: there may very well be (and usually are) cases where the parties have simply not considered the situation in hand, that is where there simply is no intention to ascertain.[10] Despite this, the court is still trying to establish what the parties *would* have intended had they thought about it at the time of contract formation. This is done by extrapolating what the parties have agreed (and *not* agreed), as against the background facts at the time of contract formation. It may not be easy to do this but the court will nevertheless undertake this task, all the while being guided by the objective principle, that is what a reasonable person would suppose the parties meant (or would have meant).

## 3. Why Does The Common Law Take an Objective Approach?

**1.7** The common law takes an objective approach to contractual interpretation, as opposed to the civil law tradition (albeit, this difference in approach is, in

6 (1999) 2 HKCFAR 279, [1999] 4 HKC 707 (CFA) at 296/726, per Lord Hoffmann NPJ.
7 [2009] AC 1101, [2009] 4 All ER 677 (HL).
8 (2011) 14 HKCFAR 534, [2011] HKCU 976 (CFA) at [73], per Ribeiro PJ (cited with approval in *Sinoearn International Ltd v Hyundai-CCECC Joint Venture (a firm)* (2013) 16 HKCFAR 632, [2013] HKCU 2273 (CFA) at [77], per Tang PJ).
9 *Bank of Credit & Commerce International SA v Ali* [2002] 1 AC 251 (HL) at [8], per Lord Bingham.
10 D McLauchlan, 'Contract interpretation: what is it about?' (2009) 31(1) Syd L R 5, Part 2.





practice, not always as clear as may first appear[11]). An example of the civil law approach[12] can be found in Article 4.1 of the *Unidroit Principles of International Commercial Contracts* (2010 edn):

> (1) A contract shall be interpreted according to the common intention of the parties.
> (2) If such an intention cannot be established, the contract shall be interpreted according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances.

**1.8** As can be seen from Article 4.1, the objective approach is only a *secondary* 'fall back' mechanism for interpreting a contract, that is when it is not possible to ascertain the subjective common intention of the parties. Indeed, a civil law lawyer might question, given that contract law is about the voluntary assumption of liability, why the common law shuns a method of interpretation which focuses on what the parties actually, subjectively intended. However, there are several justifications for the common law's objective approach.

**1.9** First, the objective approach to the construction of contracts is congruent with the general objective theory of the common law of contract. Indeed, the question of whether a contract was actually formed, and on what terms, is (generally) determined objectively.[13] Although it may be questioned whether contract formation should be determined purely objectively (that is, how a reasonable person would understand the words or actions of the parties) as opposed to being determined by how a reasonable person *in the position of the promisee* would understand the words or actions of the promisor,[14] it is nevertheless clear that the exercise is to be carried out objectively, by considering how a reasonable person (having all the background knowledge which would reasonably have been available to the parties at the time of the (alleged) contract formation) would understand it.[15]

11 S Vogenauer, 'Interpretation of contracts: concluding comparative observations', Ch 7, in Burrows and Peel (Eds), *Contract Terms* (Oxford, 2007).
12 Other than in mainland China, as noted above, n 2.
13 *Smith v Hughes* (1871) LR 6 QB 597 (CA, Eng) at 607, per Blackburn J. However, one exception to this objective approach is where the offeree knows that the offeror does not intend the terms of the offer to be those that the natural meaning of the words would suggest (ie as they objectively appear). In such a situation, the offeree cannot, by purporting to accept the offer, bind the offeror to a contract: see *Shogun Finance Ltd v Hudson* [2004] 1 AC 919 (HL) at [123], cited and applied in *Shanghai Tongji Science & Technology Industrial Co Ltd v Casil Clearing Ltd* (2004) 7 HKCFAR 79, [2004] 2 HKLRD 548, [2004] HKCU 380 (CFA) at [45], per Ribeiro PJ.
14 See, for example, D McLauchlan, 'The "drastic" remedy of rectification for unilateral mistake' (2008) 124 LQR 608 at 611; G McMeel, *The Construction of Contracts* (2nd edn, Oxford, 2011) Ch 3; and J Carter, *The Construction of Commercial Contracts* (Hart, 2013) at [2.18]–[2.22].
15 *Investors Compensation Scheme v West Bromwich Building Society* [1998] 1 WLR 896 (HL) at 912 per Lord Hoffmann. Note, for the distinction between the approach to formation and interpretation, see G McMeel, *The Construction of Contracts* (2nd edn, Oxford, 2011) Ch 3.

**1.10** A second reason for taking the objective approach to contract interpretation is that it can sometimes be very difficult (if not impossible) to establish the subjective *common* intention of the parties. Even if the subjective intention of each party can be ascertained, it can be extremely difficult to determine which parts of those respective (subjective) intentions were held in common. This is especially problematic given that many disputed contractual issues will not have been considered by the parties during contract formation or the drafting of the contract;[16] rather, they may have simply agreed to the words in the written document, without fully understanding what they mean, just in order to 'get the deal done'.

**1.11** One solution to this would be to ask what a reasonable person would have understood the parties to have intended from the parties' words and actions. Lord Wilberforce has noted[17] that the words used in a contract often mean different things to each party but may still be accepted because that is the only way to achieve agreement, with the hope that disputes will not arise. According to his Lordship, the only course then is to ascertain the *natural* meaning of those words, it being 'dangerous'[18] to admit evidence of one party's subjective intention and that it would be too speculative to know whether this subjective intention was common to both parties.

**1.12** A third reason for the objective approach is that it is certain,[19] thereby saving time and money. Whereas *subjective* interpretations have unpredictable outcomes, as well as taking time to establish, *objective* interpretations are based on external manifestations (usually found within the written contract), making it easier and quicker to predict the outcome.

**1.13** A fourth reason for the objective approach in the common law of interpretation is that it protects third parties, such as assignees. Since third parties are not parties to the contractual negotiations or drafting, they could be prejudiced if an interpretation of a term is made other than how it appears (objectively) in the contractual document.[20]

## 4. Criticisms of the Objective Approach

**1.14** Critics of the objective approach argue that the pursuit of objectivity goes too far. For example, Lord Nicholls has questioned (extra-judicially)[21] why the parties' actual intentions cannot be considered to assist in determining the

16 *Dumbrell v The Regional Group of Companies Inc* (2007) 279 DLR (4th) 201 (CA, Canada) at [50].

17 *Prenn v Simmonds* [1971] 1 WLR 1381 (HL) at 1385, per Lord Wilberforce.

18 ibid.

19 *President of India v Jebsens (UK) Ltd (The General Capinpin, The Proteus and The Free Wave)* [1991] 1 Lloyd's Rep 1 (HL) at 9, per Lord Goff.

20 *Chartbrook Ltd v Persimmon Homes Ltd* [2007] 2 P & CR 9 (HCt, Eng) at [35]–[38] per Briggs J (note, this first instance decision was overruled, but not on this point).

21 D Nicholls, 'My kingdom for a horse: the meaning of words' (2005) 121 LQR 577 at 581. See also D McLauchlan, 'Contract interpretation: what is it about?' (2009) 31(1) Syd L R 5 (at 15) and 'The contract that neither party intends' (2012) 29 JCL 26.





objective purpose of a contractual provision or the objective meaning of the words used. According to his Lordship, 'Why should the judge have to guess when he can know?'[22]

**1.15** However, although evidence of the parties' subjective intentions may enable the court to gain a better understanding of what they intended, this would destroy the objectivity of the exercise and replace it with a subjective method for ascertaining the common intentions of the parties, with all the uncertainty, costs and delays that result from such subjective interpretations. Whereas, the common law tends to favour pragmatism and certainty over absolute justice, there being many examples of this throughout the law of contract.

## 5. The Ultimate Aim

**1.16** Essentially, the ultimate aim of contractual interpretation is to establish the objective intention of the contracting parties. This is the overall guiding principle upon which all the other principles of contractual construction aim to realise.



22 ibid.

**2.9** Nevertheless, the entire agreement clause device could be viewed as merely persuasive evidence rather than conclusive evidence that the document manifests the entire contract between the parties.[10] Indeed, it could simply be included as a standard boiler-plate clause and not actually constitute a true statement as to what the parties have agreed.[11] On the other hand, it might be argued that, if the construction of contracts is, indeed, concerned with establishing the *objective* intention of the parties, there is no more obvious outward manifestation of intent than what is written in the contract document, including a statement that the document contains the entire agreement between the parties. Furthermore, if entire agreement clauses are not conclusive, then this will undermine the very commercial certainty which the common law strives for, as well as undermine freedom of contract and the parties' autonomy to stipulate and agree that what they have written within the four corners of the document constitutes the entirety of the contract. Fortunately, the courts do recognise the efficacy of entire agreement clauses and will, usually, give effect to them.

**SIDE NOTE:**

**What is the difference between an entire agreement clause and a non-reliance clause?**

**2.10** The non-reliance clause is a typical boiler-plate clause designed to preclude arguments of misrepresentation based on any representations made during pre-contractual negotiations.[12] Essentially, the parties acknowledge in writing that they have not relied upon any pre-contractual representations in entering into the contract and, as such, are confined to bringing an action for breach of express warranties only.

**2.11** In this regard, the non-reliance clause is distinct, and serves a different purpose, from an entire agreement clause. Whereas the non-reliance clause seeks to exclude liability for misrepresentation by stating that any pre-contractual representations have not been relied upon, the entire agreement clause seeks to exclude collateral warranties by asserting that the contract, as written, contains all of the agreed terms and therefore constitutes the whole agreement.[13] Nevertheless, it is clear to see how the non-reliance clause supplements the entire agreement clause insofar as attempting to secure and uphold the contract as agreed on the terms within it.[14]

**2.12** Although both entire agreement clauses and non-reliance clauses are sometimes put together in the same provision, it is advisable to divide them up into two separate provisions in case the non-reliance clause is challenged and invalidated under statute,[15] thereby resulting in the whole provision being struck out (entire agreement clause included).[16]

**2.13** A typical non-reliance clause:

> The Parties agree that no statements or representations made by either Party have been relied upon by the other in agreeing to enter into the Contract.

**2.14** A typical entire agreement clause:

> The Parties agree that the terms and conditions contained in this Contract represent the entire agreement between the Parties.

## 5. The Contract Must Be Read as a Whole

**2.15** The words and phrases of a contract cannot be read in isolation: they must be read and interpreted in light of the rest of the contract, whether it is contained in one document or a series of documents. Indeed, the extent of the parties' respective promises must be determined from the contract as a whole, considering the relevant provisions in harmony with the rest of the contract.[17]

## 6. Limiting the Scope of Words

**2.16** Reading the contract as a whole often leads to words which are expressed as having general application being limited in their scope. In other words, an apparently broad effect of a particular contract clause can be limited by reference

10 English Law Commission Report, *Law of Contract: The Parol Evidence Rule*, Law Com No 154 at 2.15.

11 D McLauchlan (2012) 128 LQR 521 at 531.

12 Note the subtle distinction between a non-reliance clause and a 'no representation' clause: the latter serves a very similar function to the former but it seems less plausible that no representations have been made whatsoever, hence it is usually considered to be more apposite to include a non-*reliance* clause in a contract.

13 See, for example, *AXA Sun Life Services Plc v Campbell Martin Ltd* [2011] EWCA Civ 133 (CA, Eng).

14 For more on non-reliance clauses, see L Mason, 'Precluding liability for pre-contractual misrepresentation: the function and validity of non-reliance clauses' (2014) JBL 313.

15 By virtue of s 4 of the Misrepresentation Ordinance (Cap 284).

16 As stated in *Thomas Witter Ltd v TBP Industries Ltd* [1996] 2 All ER 573 (HCt, Eng) at 598, per Jacob J: 'The term is not severable; it is either reasonable as a whole or it is not.'

17 *Chamber Colliery Co Ltd v Twyerould* (1893), noted [1915] 1 Ch 268 (HL) at 272, per Lord Watson; *Australian Broadcasting Commission v Australasian Performing Right Association Ltd* (1973) 129 CLR 99 (HCA) at 109, per Gibbs J; and *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313 (HL) at 384, per Lord Mustill.

to the rest of the contract where, reading the contract as a whole, it is clear that the parties did not (objectively) intend that particular clause to be given a broad or literal meaning.[18]

**EXAMPLE:**

**Vaswani v Italian Motors (Sales & Services) Ltd**
**[1996] 1 WLR 270 (PC: on appeal from Hong Kong)**

**2.17** See Appendix 1.

## 7. Extending the Scope of Words

**2.18** It is possible, though rare, for words in a contract to be given a wider meaning than their natural meaning. Although such a construction results in a broader meaning than the ordinary meaning of the words, it does so because that is what those words meant in light of the contract as a whole.[19]

## 8. Looking at the Transaction as a Whole

**2.19** Where an agreement comprises several contract documents, each entered into by the parties in relation to one general (overall) transaction, the court will read *all* the transaction documents together when interpreting *one* of them.[20]

## 9. What Happens If Contractual Provisions Conflict with Each Other?

**2.20** If two contractual clauses conflict with each other, there are certain ways of dealing with such a problem. First, it should be noted that some contractual provisions carry more weight than others. For example, where there is a conflict between the recitals and the substantive clauses, the substantive clauses will be

18 See, for example, *Nereide SpA di Navigazione v Bulk Oil International Ltd (The Laura Prima)* [1981] 3 All ER 737, [1982] 1 Lloyd's Rep 1 (HL), which concerned a dispute over demurrage payable under a charterparty, where the word 'berth' in one clause was limited in scope by reference to another clause.

19 See, for example, *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313 (HL), which concerned a dispute as to liability under a reinsurance contract, where the phrase 'actually paid' – when read in the context of the whole policy – did not constitute a condition precedent to recovery under the policy.

20 *Smith v Chadwick* (1882) 20 Ch D 27 (CA, Eng) at 62–63, per Jessel MR. For example, in *Holding & Barnes Plc v Hill House Hammond Ltd* [2002] 2 P & CR 11 (CA, Eng), which concerned the interpretation of a repair covenant in a commercial lease agreement, the parties had entered into a total of seven leases as part of the same transaction and, from reading all the transaction documents, it was clear that a mistake had been made in the particular lease agreement at issue.





preferred.[21] Another example would be where provisions included as standard form conflict with provisions *expressly* agreed or adapted by the parties. In this situation, greater weight will be attached to those expressly chosen provisions since these are the ones which the parties can be taken to have more properly addressed their minds and intended to prevail.[22]

**EXAMPLE:**

**Pre-printed or hand-written?**

**2.21** In an estate agency's standard form 24-month lease agreement, there may be a *pre-printed* 'break clause' allowing the tenant to surrender the lease to the landlord, by giving one month's notice, after the 12th month of the lease term. Nevertheless, the parties may agree, by *hand-writing* on the actual lease agreement document, that there is to be *no* break clause (for example, in return for a discounted rent). However, if they forgot to put a line through the pre-printed break clause (and/or initial it), there will be a conflict of contractual provisions. In this situation, the expressly agreed specific provision – that is, the hand-written one – should prevail.

**2.22** Secondly, where there is a conflict between general clauses and specific clauses, the court is likely to construe the general clause in such a way that does not impinge upon matters provided for in the specific clause.[23] Of course, where the contract contains a general clause which overlaps with a specific clause but that general clause is expressed as 'subject to' the specific clause, then no conflict will arise in the first place.

**2.23** Thirdly, it should be noted that, in a conflict between two clauses within the contract, the order in which the clauses appear in the document is irrelevant: the parties' intentions cannot be determined from the mere positioning of one clause coming after or before another (conflicting) clause.[24]

**2.24** Fourthly, if there is a conflict between contractual provisions between *documents*, the court will, as far as possible, read the documents as complementing each other and as expressing a coherent commercial intention of the parties.

21 *In Re Moon* (1886) 17 QBD 275 (CA, Eng) at 286, per Lord Esher MR. See also Appendix 9.

22 *Homburg Houtimport BV v Agrosin Private Ltd (The Starsin)* [2004] 1 AC 715 (HL) at [11], per Lord Bingham. In this case, more importance was attached to the front page of a bill of lading where transaction details had been added to it rather than the back page which contained pre-printed standard form terms.

23 *William Sindall Plc v Cambridgeshire City Council* [1994] 1 WLR 1016 (CA, Eng) at 1024, per Hoffmann LJ and *Yarm Road Ltd v Hewden Tower Cranes Ltd* [2003] EWCA Civ 1127, [2003] 90 Con LR 1 (CA, Eng) at [41], per Laws LJ. In the latter case, which concerned the hire of a crane, the general indemnity clause which contained no qualifications to the hirer's right to an indemnity was held to give way to the specific indemnity clause which qualified that right.

24 *Re Atlantic Computers plc* [1995] BCC 696 at 698 (HCt, Eng), per Chadwick J.

However, where there is a clear and irreconcilable discrepancy between two or more documents, the court may consider the contractual order of precedence to resolve it.[25] Indeed, in situations where the contract comprises several documents (such as construction contracts), the parties may have included an 'order of precedence' clause so as to avoid any future dispute caused by any inter-document conflict by stipulating, in descending order, which documents take precedence over others.[26]

## 10. The Written Document will be Construed in its Context

**2.25** The court will construe the written contract in light of the background facts, that is within its context.[27] Whereas interpreting a contract mostly (or entirely) on the words used in the document has the benefit of being quicker (and therefore cheaper) and more certain, it might be argued that words have little meaning in isolation from the surrounding facts and so are only properly given meaning (and therefore reveal the parties' objective intention) when read in their context. However, there have always been divergent judicial attitudes on exactly how much external evidence should be available when interpreting a written contract.

## 11. Judicial Attitudes toward Construction in Context

**2.26** The view that the courts should interpret a contract based mainly (or entirely) on its wording has the advantage of bringing certainty to the commercial playing field. It also saves time (and therefore expense) since it does not involve sieving through lots of background information, much of which will, in any event, be inadmissible or irrelevant to the construction issue.[28] Furthermore, if background information is to be referred to, it may prejudice the interests of any third parties who acquire an interest in the contract (such as through assignment) yet who have no access to such background information that was available to the original parties.[29]

**2.27** Essentially, it has been argued, where the words used are unambiguous and have a sensible meaning, there should be no reason to consider the surrounding

25 *RWE Npower Renewables Ltd v JN Bentley Ltd* [2014] EWCA Civ 150 (CA, Eng) at [15], per Moore-Bick LJ.

26 L Mason, 'Order of precedence clauses: an automatic means of resolving discrepancies between contract documents?' (2014) 35 Bus L R 106.

27 Indeed, 'context is the starting point (together with purpose) rather than looking at what may be the natural and ordinary meaning of words': see *Fully Profit (Asia) Ltd v Secretary for Justice* (2013) 16 HKCFAR 351, [2013] 6 HKC 374 (CFA) at [15], per Ma CJ.

28 *Wire TV Ltd v CableTel (UK) Ltd* [1998] CLC 244 (HCt, Eng) at 257, per Lightman J.

29 A Berg, 'Richard III in New Zealand' (2008) 124 LQR 6. See below.





circumstances which might alter that meaning.[30] Where the language is unambiguous, 'textualists' argue that the contract should be interpreted *as written* since the very purpose of having a formal written contract is to prevent disputes and reduce the necessity for litigation.[31] Indeed, as noted above, commercial parties can use an 'entire agreement' clause to try and preclude extrinsic evidence from the interpretation of the contract.

**2.28** However, there is another viewpoint that words should always be construed within their context as they cannot have any meaning outside of such context. Indeed, such '*con*textualists' note that it is people who give meanings to words rather than the words themselves having a fixed meaning.[32] Accordingly, the court should place itself, mentally, in the position of the parties as at the time of contract formation so as to ascertain the meaning of the words according to the circumstances in relation to which they were used.[33]

### *11.1 The prevailing approach*

**2.29** It seems beyond doubt that the prevailing approach is contextualism, whereby the court will read the words of a written document in the context of the background facts. Indeed, Lord Hoffmann NPJ categorically stated in the Court of Final Appeal case of *Jumbo King Ltd v Faithful Properties Ltd* that:

> The construction of a document is not a game with words. It is an attempt to discover what a reasonable person would have understood the parties to mean. And this involves having regard, not merely to the individual words they have used, but to the agreement as a whole, the factual and legal background against which it was concluded and the practical objects which it was intended to achieve.[34]

30 *National Bank of Sharjah v Dellborg* [1997] EWCA Civ 2070, [1997] Lexis Citation 3549 (CA, Eng), per Saville LJ. Certainly, it seems that at least where there is a natural and ordinary meaning of the word in question, that natural and ordinary meaning will not be ignored: see *Pony HK World Ltd v Vand Petro-Chemicals (BVI) Co Ltd* (2013) 16 HKCFAR 937, [2013] HKCU 2855 (CFA) at [30]–[31], per Lord Phillips NPJ.

31 *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 240 CLR 45 at [70]–[71] and [98]–[103] (HCA), per Kirby J (dissenting). See also JJ Spigelman (former Chief Justice of New South Wales), 'From text to context: contemporary contractual interpretation' (2007) 81 ALJ 322 and 'Contractual interpretation: a comparative perspective' (2011) 85 ALJ 412.

32 D McLauchlan, 'Contract interpretation: what is it about?' (2009) 31(1) Syd L R 5 at 18 and 'Plain meaning and commercial construction: has Australia adopted the *ICS* principles?' (2009) 25 JCL 7. See also J Steyn, 'The intractable problem of the interpretation of legal texts' (2003) 25(1) Syd L R 5.

33 *Charrington & Co Ltd v Wooder* [1914] AC 71 (HL) at 82, per Lord Dunedin and *River Wear Commissioners v Adamson* (1877) 2 App Cas 743 (HL) at 763, per Lord Blackburn.

34 (1999) 2 HKCFAR 279, [1999] 4 HKC 707 (CFA) at 296/726, per Lord Hoffmann NPJ. Indeed, it has been argued that this approach of the court putting itself in the shoes of the contracting parties is nothing new but, rather, has a long pedigree: see Lord Bingham, 'A new thing under the sun? The interpretation of contract and the *ICS* decision' (2008) 12 Edin L R 374.

**2.30** This echoes what his Lordship stated in the first two of five principles set out in his landmark judgment in the UK House of Lords case of *ICS*,[35] that is to ascertain how a reasonable person would understand the document having had 'all the background knowledge which would reasonably have been available to the parties' at the time of contract formation, with such relevant background knowledge including 'absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man', albeit except evidence of prior negotiations.[36]

**2.31** More recently, the contextual approach espoused by Lord Hoffmann NPJ has been reiterated in the Court of Final Appeal case of *Fully Profit (Asia) Ltd v Secretary for Justice* by Chief Justice Ma:

> We have been referred to the very well-known statement of principle regarding the construction of contracts contained in the speech of Lord Hoffmann in [*ICS*], to which can be added the judgment also of Lord Hoffmann NPJ in *Jumbo King*... . What emerges from these cases – and other authorities on contractual interpretation – is *the overall importance of context when construing contractual terms*. The statements of principle in [*ICS*] and in *Jumbo King* refer time and again to *the relevant background against which the relevant contract and contractual terms must be viewed.*[37][Emphasis added]

**EXAMPLE:**

**New World Harbourview Hotel Co Ltd v ACE Insurance Ltd (2012) 15 HKCFAR 120, [2012] HKCU 419 (CFA)**

**2.32** See Appendix 2.

## 11.2 *Contextualism prevails even where the contract words are unambiguous*

**2.33** It seems that the courts will take a contextual approach to interpretation of contracts, even where the words are clear and unambiguous. In other words,

35 [1998] 1 WLR 896 (HL) at 912–913, per Lord Hoffmann.

36 Indeed, particularly with commercial contracts, Lord Wilberforce has stated that the court should know the 'commercial purpose' of the contract, including 'the genesis of the transaction, the background, the context, the market in which the parties are operating': see *Reardon Smith Line Ltd v Yngvar Hansen-Tangen* [1976] 1 WLR 989 (HL) at 995–6. However, this has been criticised as perpetuating the cost of litigation: see Sir Christopher Staughton, 'How do the courts interpret commercial contracts?' (1999) 58 CLJ 303 at 307.

37 (2013) 16 HKCFAR 351, [2013] 6 HKC 374 (CFA) at [15], per Ma CJ.





there does not need to be ambiguity in order for the court to take the surrounding circumstances into account.[38] Rather, 'context is the starting point'.[39]

**SIDE NOTE:**

**The position in Australia and England**

*Australia*

**2.34** Interestingly, the position in Australia is not entirely clear.[40] This uncertain position stems from the High Court of Australia case of *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales*[41] ('*Codelfa*'). Some Australian courts believe that *Codelfa* is authority for the requirement of ambiguity before a court can interpret a contract by reference to the background facts. This was the view of the High Court of Australia in *Western Export Services Inc v Jireh International Pty Ltd,*[42] which confirmed that, until the High Court of Australia reconsiders its decision in *Codelfa,* that decision is binding throughout Australia.[43]

**2.35** The belief that the *Codelfa* is authority for requiring ambiguity as a prerequisite for *contextual* construction is based on the following statement of Mason J in that case:

> The true rule is that evidence of surrounding circumstances is admissible to assist in the interpretation of the contract if the language is ambiguous or susceptible of more than one meaning. But it is not admissible to contradict the language of the contract when it has a plain meaning.[44]

**2.36** However, other Australian courts believe that, when reading Mason J's judgment as a whole, he was *not* intending to impose what appears to be a restriction on the admissibility of background facts given that Mason J appeared, elsewhere in the judgment, to be approving Lord Wilberforce's comments to that effect in two earlier cases.[45] Australian judicial support for this interpretation of *Codelfa* is found in *Franklins Pty Ltd v Metcash Trading Ltd*,[46] *Lion Nathan*

38 *Westminster City Council v National Asylum Support Service* [2002] 1 WLR 2956 (HL) at [5], per Lord Steyn and *Ansley v Prospectus Nominees* [2004] 2 NZLR 590 (CA, New Zealand) at [36], per Gault P. Contrast earlier cases, such as *Charrington & Co Ltd v Wooder* [1914] AC 71 (HL) at 77 where Viscount Haldane LC considered that the surrounding circumstances are only relevant where the words are ambiguous.

39 *Fully Profit (Asia) Ltd v Secretary for Justice* (2013) 16 HKCFAR 351, [2013] 6 HKC 374 (CFA) at [15], per Ma CJ.

40 D McLauchlan, 'Plain meaning and commercial construction: has Australia adopted the *ICS* principles?' (2009) 25 JCL 7.

41 (1982) 149 CLR 337, (1982) 41 ALR 367 (HCA).

42 (2011) 282 ALR 604 (HCA). Note, this case only concerned an application for special leave to appeal and, therefore, is only of persuasive authority.

43 ibid, at [2] and [3].

44 (1982) 149 CLR 337 at 352, (1982) 41 ALR 367 at 374 (HCA). per Mason J.

45 *Prenn v Simmonds* [1971] 1 WLR 1381 (HL) at 1383–4 and *Reardon Smith Line Ltd v Yngvar Hansen-Tangen* [1976] 1 WLR 989 (HL) at 995–6.

46 [2009] 76 NSWLR 603 (CA, NSW).

*Australia Pty Ltd v Coopers Brewery Ltd*[47] and appears to have at least some support from the High Court of Australia in *Pacific Carriers v BNP Paribus*.[48]

**2.37** Therefore, on balance, while the Australian position as to contextualism in contract interpretation is somewhat unclear, it is arguably more likely that background facts *will* be regarded as admissible in contract interpretation, regardless of the absence of ambiguity.[49]

*England*

**2.38** In *Wood v Capita Insurance Services Ltd*,[50] it was clearly stated that the textual and contextual approaches to contract interpretation are not in conflict with each other. Rather, according to the Supreme Court, it will depend on the circumstances of the agreement as to which approach the court lays greater emphasis. According to Lord Hodge (with whom there was unanimous agreement):

> Textualism and contextualism are not conflicting paradigms in a battle for exclusive occupation of the field of contractual interpretation. Rather, the lawyer and the judge, when interpreting any contract, can use them as tools to ascertain the objective meaning of the language which the parties have chosen to express their agreement. The extent to which each tool will assist the court in its task will vary according to the circumstances of the particular agreement or agreements.[51]

**2.39** For example, according to the court, sophisticated and complex contracts which have been negotiated and prepared by skilled professionals may be properly construed using a textual analysis. Whereas, for other contracts, there may be a greater emphasis on the factual matrix due to the contract's informality, brevity or absence of skilled professional involvement.

**2.40** Nevertheless, the court noted that even complex formal contracts, which have been professionally drawn up, may contain ambiguous terms due to, for example, conflicting aims of the parties, failures of communication, differing drafting practices, or deadlines which require the parties to compromise in order to reach agreement. In this situation, a contextual approach – considering the factual matrix and the purpose of similar provisions in contracts of the same type – may provide a better aid to interpretation.[52]

47 (2006) 236 ALR 561 (Fed Court, Aust).
48 (2004) 218 CLR 451, (2004) 208 ALR 213 (HCA) at [22].
49 R Calnan, *Principles of Contractual Interpretation* (Oxford, 2013) p 47.
50 [2017] UKSC 24 (SC).
51 ibid, at [13], per Lord Hodge.
52 Indeed, Lord Hodge noted (at [13]) the assistance of the 'iterative process' – as referred to in *Re Sigma Finance* [2009] UKSC 2, [2010] BCC 40 (SC) – in ascertaining the objective meaning of disputed provisions. This iterative process involves 'checking each of the rival meanings against other provisions of the document and investigating its commercial consequences': see [2009] UKSC 2, [2010] BCC 40 (SC) at [12], per Lord Mance.





## 12. The Extent of Admissible Background Facts

**2.41** As clarified by Lord Hoffmann in *Bank of Credit and Commerce International v Ali*,[53] the admissible background facts are those 'which a reasonable man would have regarded as *relevant*'[54] and, to this end, 'there is *no conceptual limit* to what can be regarded as background'.[55]

## 13. Limiting the Admissibility of Background Facts

**2.42** Since the interpretation exercise is an objective one, the admissibility of background facts is limited to those which a reasonable person would regard as relevant to establishing the apparent intentions of the contracting parties. Nevertheless, in order to keep in line with this objective principle, certain background facts and information are regarded as *in*admissible.

(a) First, declarations of subjective intention are inadmissible because they are irrelevant to an objective interpretation.
(b) Secondly, background facts which cannot reasonably be expected to have been known by the contracting parties at the time of entering into the contract are inadmissible since they are not relevant to ascertaining the parties' objective intention at the time of contract formation.
(c) Thirdly, prior negotiations are inadmissible since they are more concerned with subjective intentions than with objective facts; it is often the case that parties will change their positions right up to the moment of signing the contract and, therefore, what was said or agreed prior to the moment of formation is of no use in determining what was actually agreed at the time when the contract was finally signed.
(d) Fourthly, subsequent conduct is inadmissible because a contract can only have one meaning, and that meaning cannot vary over time through post-formation conduct; although subsequent conduct may provide evidence of an agreed contract variation (or maybe a waiver), it cannot establish what the parties objectively intended at the earlier time of contract formation.

**2.43** Other than these, all other background facts are relevant. Nevertheless, such other background facts can be limited for pragmatic reasons, namely in

53 [2002] 1 AC 251 (HL) ('*BCCI v Ali*').
54 ibid at [39], per Lord Hoffmann.
55 ibid.

the interests of either: commercial certainty; timely and cost-efficient dispute resolution;[56] or protecting third parties.[57]

## 16. The Knowledge of the Parties

**2.44** As Lord Hoffmann stated in the *ICS* case,[58] background facts are only relevant if they 'would reasonably have been available to the parties in the situation in which they were at the time of the contract'.[59] This accords with the objective nature of contractual interpretation, that is it is not relevant what the parties actually knew but, rather, what a reasonable person would expect them to have known. Of course, this does not include information that was known only to one party.[60]

## 17. Declarations of Subjective Intention

**2.45** Declarations of subjective intention are inadmissible as part of contract interpretation because they are irrelevant to the fundamental enquiry as to the *objective* intention of the parties: the parties cannot, themselves, adduce direct evidence as to what their intention was.[61] Indeed, as noted by Lord Hoffmann, it is often difficult to distinguish statements which simply reflect the aspirations of a particular party from statements which evince at least a provisional agreement between the parties which might elucidate the meaning of the contract which was eventually entered into.[62]

## 18. Prior Negotiations

**2.46** Unlike civil law jurisdictions,[63] English and Hong Kong common law does not admit evidence of pre-contractual negotiations as part of the background facts.

56 This being another reason for excluding prior negotiations, as recognised by Lord Hoffmann in *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] 1 AC 1101 1 (HL) at [36]–[37].

57 Third parties may have an interest in the contract (and, therefore, its interpretation) but may not have been aware of the background facts which were reasonably known to the original parties. See below.

58 *Investors Compensation Scheme v West Bromwich Building Society* [1998] 1 WLR 896 (HL) ('*ICS*').

59 ibid, at 912, per Lord Hoffmann.

60 See, for example, *United Bright Ltd v Secretary for Justice* [2012] HKCU 1585 (unreported, HCMP 382/2011, 31 July 2012) (CFI) at [53]–[54], per Sakhrani DHCJ; affirmed by [2015] 2 HKLRD 633, [2015] 4 HKC 12 (CA).

61 *Reardon Smith Line Ltd v Yngvar Hansen-Tangen (The Diana Prosperity)* [1976] 1 WLR 989 (HL) at 996 per Lord Wilberforce.

62 *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] 1 AC 1101 (HL) at [38], per Lord Hoffmann.

63 And see the Unidroit Principles of International Commercial Contracts (2010 edn), Art 4.3(a): regard to be had to 'all the circumstances', including 'preliminary negotiations between the parties'.





Such prior negotiations are considered as unhelpful to the interpretation process since parties often change their positions during their various pre-contractual communications and do so right up until a final agreement is eventually arrived at and put down in writing, recording the final consensus.[64] Indeed, despite Lord Hoffmann initially opining that the boundaries of this exception are unclear,[65] his Lordship later concluded that evidence of prior negotiations should remain excluded, not merely because they are irrelevant to ascertaining the objective intentions of the parties but, also, because the admission of such evidence would lead to uncertainty, more lengthy and costly legal advice and litigation, as well as potentially prejudicing third parties (such as assignees) who were not privy to the pre-contractual negotiations and who may have understood the contract as it appears on its face.[66]

**2.47** However, his Lordship noted that, although excluded for the purpose of drawing inferences as to the meaning of the contract, evidence of prior negotiations can be admitted for *other* purposes, such as in order to establish that a particular fact – which may be relevant as background – was within the knowledge of the parties.[67] Indeed, similar sentiments have been expressed in Australia, that is the admissibility of prior negotiations which establish objective background facts which were known to both of the contracting parties.[68] Such a distinction has also been drawn in New Zealand, that is the difference between evidence pertaining to the subjective content of prior negotiations (including their individual intentions and positions at different stages of the negotiations) and evidence which assists the objective interpretation of what the contractual wording means (including the circumstances in which the contract was entered into and any objectively perceived agreed meaning between the parties).[69]

64 *Prenn v Simmonds* [1971] 1 WLR 1381 (HL) at 1384, per Lord Wilberforce.

65 *Investors Compensation Scheme v West Bromwich Building Society* [1998] 1 WLR 896 (HL) at 913, per Lord Hoffmann. This doubtlessly encouraged the debate as to the merits of the inadmissibility of such evidence and prompted certain strong views in favour of admitting prior negotiations for the purposes of interpretation: see D Nicholls, 'My kingdom for a horse: the meaning of words' (2005) 121 LQR 577; *Yoshimoto v Canterbury Golf International Ltd* [2001] 1 NZLR 523 (NZCA) at 538–549, per Thomas J; D McLauchlan, 'Contract interpretation: what is it about?' (2009) 31 Syd L R 5; C Mitchell, 'Contract interpretation: pragmatism, principle and the prior negotiations rule' (2010) 26 JCL 134. See also, on balance, G McMeel, 'Prior negotiations and subsequent conduct – the next step forward for contractual interpretation?' (2003) 119 LQR 272.

66 *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] 1 AC 1101 (HL) at [28]–[47], per Lord Hoffmann.

67 ibid at [42]. Rather than being an exception to the rule, such 'other purposes' merely operate outside the rule. Further, his Lordship also pointed out that a claim for rectification or estoppel (see Chapters 5 and 6, respectively) also fell outside the rule.

68 *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 352, (1982) 41 ALR 367 at 375 (HCA) per Mason J (as he then was).

69 *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] 2 NZLR 444 (NZSC) at [27]–[29], per Tipping J.

Godfrey J stated that the expression 'best endeavours' meant that an obligor, such as the one in that case, is expected 'to act in a prudent and determined manner in the exertion of its efforts',[23] and that the obligor's 'nature, structure, capacity, qualifications and experience; and its other responsibilities, must all be taken into account'.[24] In this case, the Government obligor was not required to treat its obligation to the developer as taking priority over its other interests and responsibilities.

**3.16** In the Court of First Instance case of *Okachi (Hong Kong) Co Ltd v Nominee (Holding) Ltd*,[25] Poon DHCJ seemed to suggest that 'best' and 'reasonable' impose more or less the same standard, requiring the obligor to take all reasonable steps, albeit without sacrificing its own commercial interests. According to Judge Poon, 'best endeavours' means that the obligor:

> … shall take all reasonable steps which a prudent and determined man acting in his own interests and anxious in completing the transaction would have taken. Second-best endeavours will not do. If that person fails to use proper skill and care in going about the task that he undertakes to do with his endeavours, or that he deliberately delays or procrastinate the pursuit of that object, or going about doing it in such a way disregarding the interests of the person to whom he has given his undertaking, he fails in his obligations.[26]

**3.17** More recently, in the Court of Appeal case of *Hong Jing Co Ltd v Zhuhai Kwok Yuen Investment Co Ltd*,[27] Cheung JA saw no difficulty in implying into a memorandum of understanding a clause which required the defendant to use its 'best or at least reasonable endeavours'.[28] Although his Lordship did not go on to explain whether there was any material difference between 'best' and 'reasonable', the fact that he used the words 'or at least' suggests that there is a distinction between the two and that 'reasonable endeavours' imposes a *lower* standard on the obligor.

**3.18** Nevertheless, the parameters of endeavours clauses under Hong Kong law remains a little unclear, thereby creating particular uncertainty as to how far an obligor must go in its endeavours to achieve the relevant contractual object and how much of its own commercial interests it can take into account in pursuing that object. As such, it would perhaps be wise to draft such clauses in a way that clearly sets out the exact scope of the endeavours, such as duration of the obligation, the extent of costs that may be incurred or whether the obligor must take legal proceedings to appeal a third party's decision.

23 ibid at [43], per Godfrey J (relying partly on *IBM United Kingdom Ltd v Rockware Glass Ltd* [1980] FSR 335 (CA, Eng), albeit that case being of no further assistance given that 'the facts in it bear no resemblance whatever to the facts in our case').
24 ibid at [38], per Godfrey J.
25 [2005] 4 HKLRD 447, [2005] 3 HKC 408 (CFI).
26 ibid at [95], per Poon DHCJ (relying on *IBM United Kingdom Ltd v Rockware Glass Ltd* [1980] FSR 335 (CA, Eng).
27 [2013] 1 HKLRD 441, [2012] HKCU 1463 (CA).
28 ibid at [37], per Cheung JA.





## 6. Standard Form Contracts

**3.19** Standard form contracts are quite common in commercial transactions, such as those concerning charterparties, construction contracts and conveyancing transactions. The advantage of such contracts is their uniformity, resulting in consistency and commercial certainty in the industry concerned, without the need for detailed negotiation. It is therefore of vital importance that parties can be sure that the court will apply a uniform interpretation to the specific contracts concerned.[29]

**3.20** Indeed, Lord Hoffmann has noted that regard should be had to previous judicial interpretations of similar standard form contracts, given that such standard forms have often evolved from the interactions between contract draftsmen and the courts and, as such, the particular standard wording used can only be properly understood by reference to the meaning which judges have given to such wording in previous similar contracts.[30]

## 7. The Canons of Construction

**3.21** There are certain so-called 'canons of construction' which provide guidance (albeit no more than that[31]) for the interpretation of contracts. Perhaps the most widely-known canon is *contra proferentem*, that is construing a contractual provision against the party who relies on (or 'proffers') it, albeit only where the provision is ambiguous.[32] Another example canon would be *ejusdem generis*, whereby general words which follow a specific list of items can be interpreted by reference to that class of items, such that the general words will be limited to only include other items in the same class (or 'genus') as those specific items.[33] A further example is the canon of *expressio unius est exclusio alterius*, whereby if certain items in a class are expressly provided for, other items of that class are excluded and cannot, therefore, be implied.[34] However, as noted above, it is

29 *Pioneer Shipping Ltd v BTP Tioxide Ltd (The Nema)* [1982] AC 724 (HL) at 737, per Lord Diplock. See also *Federal Commerce and Navigation Co Ltd v Tradax Export SA (The Maratha Envoy)* [1978] AC 1 (HL) at 8. For example, standard ISDA Master Agreements, provided by the International Swaps and Derivatives Association, for use in the swaps and loan markets: see *Re Lehman Brothers International (Europe) (in admin)* [2013] EWCA Civ 188.
30 See, for example, *Beaufort Developments (NI) Ltd v Gilbert-Ash (NI) Ltd* [1999] 1 AC 266 (HL) at 274, per Lord Hoffmann.
31 Indeed, such canons might be considered as part of the 'intellectual baggage' referred to by Lord Hoffmann in the *ICS* case at 912.
32 See below.
33 See below.
34 See, for example, *Miller v Emcer Products Ltd* [1956] Ch 304 (CA, Eng). An illustration of this canon would be an express provision for 'Stella Artois, Carlsberg and Corona': in this situation, since these items of the same class (ie lager) are *expressly* provided for, another item of the same class (such as 'Carling') cannot be implied.

important to realise that such canons are *not* rules of construction, they are merely discretionary aides which may be used in various contexts.[35]

## 7.1 Ejusdem generis

**3.22** Where general words follow a specific list of items, those general words can be interpreted by reference to that class of items; that is the general words can, according to the principle of *ejusdem generis*, be limited to only include other items in the same class as those preceding specifically listed items.[36]

**EXAMPLE:**

**Ejusdem generis**

**3.23** A simple illustration would be a clause expressly referring to 'Lions, Tigers, Leopards, Cheetahs and other wild animals'. The general words 'and other wild animals' would be restricted to other types of wild cat (wild cat being the common genus of the specific list of animals) and so would include Panthers, Lynx and Cougars rather than wild animals generally (such as Wolves, Elephants, Rhinos and Gorillas).

**3.24** However, the problem with this canon of construction is that it fails to recognise that parties often use general words for the very purpose of *expanding* the scope of the list of items specifically referred to.[37] Indeed, the use of general words may have been intended to operate as a 'catch all' expression.[38] As such,

35 For an example of a construction principle 'long sanctioned in Courts of equity' in relation to release agreements, see *Bank of Credit and Commerce International SA v Ali (No 1)* [2001] 2 WLR 735, [2002] 1 AC 251 (HL) at [12] and [14], per Lord Bingham.

36 Note, the same principle does not apply where the general words *precede* the specific list of items.

37 See, for example, *Chandris v Isbrandtsen-Moller Co Inc* [1951] 1 KB 240 (CA, Eng) at 246, per Devlin J (turpentine was construed as being within the meaning of 'other dangerous cargo' alongside expressly provided for items such as ammunition and explosives); cf *Cosco Bulk Carrier Co Ltd v Team-Up Owning Co Ltd (The Saldanha)* [2010] EWHC 1340 (Comm) (HCt, Eng) (seizure of a ship by pirates did not fall within 'any other cause').

38 A common example can be found in *force majeure* clauses: reference to 'earthquakes, volcanic eruptions, tsunamis, *and other such events*' may have been intended to include all such 'other' events which occur outside the control of the parties, which would include civil unrest and acts of terrorism. However, the latter two events may not be covered if the clause was construed *ejusdem generis* since the items specially listed are all acts of nature (or 'acts of God') whereas civil unrest and terrorism are both acts of mankind. Nevertheless, if either civil unrest or terrorism were expressly included in the list, then *ejusdem generis* could be applied more widely so that the clause could cover *any* events which are outside the control of the parties. For more on *force majeure* clauses, see Appendix 8.





*ejusdem generis* will not be applied automatically; it operates no more than as a guide to construction.[39]

## 7.2 Contra proferentem

**3.25** Where there is an ambiguity, the *contra proferentem* canon of construction allows for the ambiguous contractual provision to be construed against the party who relies on (or 'proffers') it. Note, however, it only applies where the provision in question is ambiguous.[40]

**EXAMPLE:**

**Contra proferentem**

**3.26** *In Houghton v Trafalgar Insurance Co Ltd*,[41] a car insurance policy stated that it did not cover damage which occurred if the car was carrying 'any load in excess of that for which it was constructed'. An accident occurred at a time when the car was carrying six passengers and the insurance company argued that, since the car was designed to carry only five persons, the insurance policy did not cover the accident. The insurance company reasoned that the car was carrying a 'load in excess of that for which it was constructed' (as exempted by the insurance policy) and that, accordingly, the insurance company was not liable for any loss or damage resulting from the accident.

However, the court decided that the word 'load' was ambiguous and should, therefore, be construed *contra proferentem* against the insurance company. As such, the court held that 'load' was a reference to weight rather than the number of passengers and so the insurance policy *did* cover the loss and damage that occurred. According to Somervell LJ:

> I think that it would need the plainest possible words if it were desired to exclude the insurance cover by reason of the fact that there was at the back one passenger more than the seating accommodation.[42]

**3.27** The *contra proferentem* canon has, however, attracted some criticism. First, there may be a practical difficulty of applying the canon insofar as knowing which party is the *proferens* against whom the ambiguity is to be resolved. Although the party relying on the clause will often be the party who drafted the contract, this is not always so; and it may be that both parties are relying on the same clause in different ways. Indeed, it may be that both parties have contributed to the wording of the clause in question as part of the negotiating process. Another criticism

39 *Chandris v Isbrandtsen-Moller Co Inc* [1951] 1 KB 240 (CA, Eng) at 244, per Devlin J.

40 See, for example, *New World Harbourview Hotel Co Ltd v ACE Insurance Ltd* (2012) 15 HKCFAR 120, [2012] HKCU 419 (CFA) at [2], [34] and [42], per Bokhary PJ and Mason NPJ, respectively. See also Appendix 2.

41 [1954] 1 QB 247 (CA, Eng).

42 ibid, at 249.

of the canon is that its application requires considering the particular clause in isolation, which defeats the well-established principle that contracts should be read as a whole.[43]

**3.28** Accordingly, in recent times, the canon of *contra proferentem* tends to be very much restricted to two particular types of clauses which the courts regard as objectionable, that is: (a) exemption clauses which seek to exempt liability for breach of contract, fraud[44] or negligence;[45] and (b) termination clauses which seek to allow for contract termination in the event of a minor breach.[46]

## 8. Resolving Ambiguity Using Business Common Sense

**3.29** Since the *contra proferentem* canon tends to be restricted to exemption clauses and termination clauses, ambiguous clauses (generally) will be construed according to the meaning which affords the most 'business common sense'.[47] Essentially, where there is more than one plausible interpretation, the most commercially sensible reading will be regarded as the one most likely (objectively) to have been intended by the parties.[48]

**3.30** Since background facts are admissible for the purpose of contract interpretation,[49] not only might a prima facie ambiguous clause become unambiguous when read against those facts but a prima facie unambiguous clause may actually become ambiguous when read in the context of background facts. Nevertheless, even where such ambiguity only arises when reading the clause in the light of certain background facts, the court can still choose between equally

43 See Chapter 2.

44 See below. Note, a person can never exempt liability for his own fraud but may, with clear wording, be able to exclude liability for his agent's fraud: see *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] UKHL 6, [2003] 1 CLC 358 (HL) at [98] and [122], per Lords Hobhouse and Scott, respectively.

45 See below. Note, exclusion clauses are treated with more hostility than limitation clauses, there being an 'inherent improbability' that one party intended to release the other party from *all* liability arising from a particular default: see *Ailsa Craig Fishing Co Ltd v Malvern Fishing Co Ltd* [1983] 1 WLR 964 (HL) at 970, per Lord Fraser; *Sinoearn International Ltd v Hyundai-CCECC Joint Venture (a firm)* (2013) 16 HKCFAR 632, [2013] HKCU 2273 (CFA) at [76], per Tang PJ.

46 See below.

47 *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50 (SC) at [21], per Lord Clarke (noted in L Mason, 'The role of "business common sense" in the construction of commercial contracts' (2011) 33 Bus L R 32).

48 Note, however, the mere possibility of a different meaning from the natural meaning does not constitute ambiguity. The court will not 'search' for ambiguity: see *Melanesian Mission Trust Board v Australian Mutual Provident Society* [1996] UKPC 53, [1997] 2 EGLR 128 (PC: on appeal from New Zealand) at [8] per Lord Hope.

49 See Chapter 2.





plausible interpretations in order to ascertain the parties' objective common intention based on business common sense.[50]

**3.31** However, in the UK at least, there has been suggestion that there has been a recent shift away from too much emphasis being placed on business common sense and the contextual approach.[51] In particular, it has been noted that recourse to commercial common sense and surrounding circumstances should not be made to undervalue the importance of the particular wording used by the parties, over which they have control and can be presumed to have specifically directed at the issue to be covered.[52]

**SIDE NOTE:**

**Problems with the application of 'business common sense'**

*What if there are competing interpretations, both based on business common sense?*

**3.32** There is judicial acknowledgment that, where a court has to resort to applying business common sense, frequently there are competing assertions as to which interpretation makes business common sense in that particular context and that, in such situations, the court will have difficulty in concluding with confidence which interpretation makes *more* business common sense.[53] Indeed, the court simply has to decide between the parties' opposing assertions as to which interpretation yields the most commercially sensible result and, on this basis, it has been acknowledged that there is 'room for error'.[54]

*Are judges in the best position, anyway, to determine what is commercially sensible?*

**3.33** It is true that there are some highly experienced commercial judges who have their own particular areas of expertise and whose opinions as to what

50 See, for example, *Batey v Jewson Ltd* [2008] EWCA Civ 18 (CA, Eng).

51 See, for example, RC Connal QC, 'Has the rainy sky dried up? *Arnold v Britton* and commercial interpretation' (2016) 20 Edin L R 71, noting *Arnold v Britton* [2015] UKSC 36 (SC). Note also *Krys v KBC Partners LP* [2015] UKPC 46 (PC: on appeal from British Virgin Islands) at [16], per Lord Sumption. See also N Andrews, 'Interpretation of contracts and "commercial common sense": do not overplay this useful criterion' (2017) 76 CLJ 36.

52 *Arnold v Britton* [2015] UKSC 36 at [17] (SC), per Lord Neuberger. Nevertheless, in this case, all the judgments *confirmed* the approach in *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50 at [21] (SC), per Lord Clarke: see [2015] UKSC 36 at [14], [76] and [108] (SC), per Lords Neuberger, Hodge and Carnwath, respectively. Indeed, the UK Supreme Court has since confirmed that, on the approach to contractual interpretation, these two cases were saying the same thing: see *Wood v Capita Insurance Services Ltd* [2017] UKSC 24 at [14] (SC), per Lord Hodge.

53 See, for example, *Cottonex Anstalt v Patriot Spinning Mills Ltd* [2014] EWHC 236 (Comm) at [57] (HCt, Eng), per Hamblen J.

54 *Torvald Klaveness A/S v Arni Maritime Corp* [1994] 1 WLR 1465 (HL) at 1473 per Lord Mustill.

is 'commercial' or 'uncommercial' are very well respected.[55] Nevertheless, there has been some very senior judicial acknowledgment that judges may not necessarily be in the best position to determine what is commercially sensible. For example, Lord Neuberger has commented:

> Judges are not always the most commercially-minded, let alone the most commercially experienced, of people, and should, I think, avoid arrogating to themselves overconfidently the role of arbiter of commercial reasonableness or likelihood.[56]

His Lordship further expressed the view (extra-judicially) that:

> … judges should be diffident before pontificating about the commercial realities of any particular interpretation. […] it does not seem obvious that a judge, who is normally fairly remote [from] business matters, would be particularly good at identifying the commercial common sense of any conclusion, let alone what a reasonable person might regard as commercially sensible.[57]

# 9. Giving Words Unnatural Meanings

**3.34** There may be circumstances (albeit, rarely) where it is objectively clear that the parties simply cannot have intended the words they used to have their ordinary meaning. In this situation, the court may give those words an *unnatural* meaning so as to accord with what the parties must, objectively, have intended. The question then becomes how far, in such circumstances, the court is prepared to apply an unnatural meaning.

## 9.1 *The extent of unnatural readings*

**3.35** Judicial opinions differ as to the extent to which a court should give an unnatural reading to the written words of a contractual document. One view is that, since words have no meaning independent of the persons who use them, if contracting parties have (objectively, based on background facts) used the 'wrong' words, then the court may treat those contracting parties as having intended *other*

55 See, for example, *Kookmin Bank v Rainy Sky SA* [2010] EWCA Civ 582, [2010] 1 CLC 829 (CA, Eng) at 840/[30], per Sir Simon Tuckey, acknowledging that the trial judge was 'an experienced commercial judge' and that his decision that a particular construction led to an uncommercial result 'should be given considerable weight by this Court'.

56 *Skanska Rashleigh Weatherfoil Ltd v Somerfield Stores Ltd* [2006] EWCA Civ 1732 (CA, Eng) at [22], per Neuberger LJ.

57 Lord Neuberger, 'The impact of pre- and post-contractual conduct on contractual interpretation', Banking Services and Finance Law Association Conference, Queenstown (11 August 2014) at [19], available at https://www.supremecourt.uk/docs/speech-140811.pdf.





words, particularly those that make business common sense.[58] Essentially, the more commercially absurd the result from the *natural* meaning of the words, the less likely it will be that the parties intended that meaning and the more likely that the court will read them so as to accord with commercial common sense.[59]

**3.36** Another view, recognising that judges may differ as to where the line is drawn between giving words a business commonsensical reading and inappropriate judicial interference in the contract, prefers a more cautious approach in the interests of commercial certainty.[60] Indeed, on this view, the courts should not have recourse to business common sense where the words are unambiguous, even where they appear capricious or unreasonable.[61] Furthermore, as noted above, judges (as opposed to experienced businessmen) are not necessarily in the best position to determine what is commercial common sense.[62]

## 9.2 *Drawing the line*

**3.37** It is important to note that the court will only very rarely give the written words used by contracting parties an unnatural meaning. First, it must be clear that something is so wrong with the language used in the written contract that the parties cannot, objectively, have intended it;[63] and, secondly, it must be clear to a reasonable person what the parties actually, objectively, intended.[64] However, the



58 *Investors Compensation Scheme v West Bromwich Building Society* [1998] 1 WLR 896 (HL) at 913, per Lord Hoffmann. Note: in this way, the court *reads* the words as changed but does not actually change them (cf rectification: see Chapter 5).

59 *L Schuler AG v Wickman Machine Tool Sales Ltd* [1974] AC 235 (HL) at 251, per Lord Reid and *Torvald Klaveness A/S v Arni Maritime Corp (The Gregos)* [1994] 1 WLR 1465 (HL) at 1473, per Lord Mustill. For example, see *Consolidated-Bathurst Export Ltd v Mutual Boiler and Machinery Insurance Co* [1980] 1 SCR 888 (Supreme Court, Canada) at 901: an insurance policy specifically excluded "corrosion" but the court read it as *including* corrosion.

60 *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313 (HL) at 368 and 387–8, per Staughton LJ and Lord Mustill, respectively.

61 *Australian Broadcasting Commission v Australasian Performing Right Association Ltd* (1973) 129 CLR 99 (HCA) at 110, per Gibbs J.

62 *Skanska Rashleigh Weatherfoil Ltd v Somerfield Stores Ltd* [2006] EWCA Civ 1732 (CA, Eng) at [22], per Neuberger LJ. Hence the increasingly cautionary approach toward business common sense: see, for example, *Arnold v Britton* [2015] UKSC 36 (SC) at [17], per Lord Neuberger. See also N Andrews, 'Interpretation of contracts and "commercial common sense": do not overplay this useful criterion' (2017) 76 CLJ 36 at 55.

63 In other words, the natural reading of the words would produce a commercially absurd result.

64 *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] 1 AC 1101 (HL) at [25], per Lord Hoffmann; *City Alliance Ltd v Oxford Forecasting Services Ltd* [2001] 1 All ER (Comm) 233 (CA, Eng) at [13], per Chadwick LJ.

court will not readily assume that the parties have made a linguistic mistake and a 'strong case'[65] must be made out in order to satisfy the first hurdle.

**3.38** Furthermore, the second hurdle may be even more difficult to satisfy given that, although it may be clear that something is wrong with the language used, it may nevertheless be very *un*clear what the parties, objectively, intended the written words to mean as there may be simply too many possible interpretations. However, in the face of this, the court will approach the task in the same way as it deals with ambiguities: it will first consider the context of the wording by reading the document as a whole and as against the background facts and, secondly, decide which interpretation seems to make the most business common sense.[66]

**3.39** Nevertheless, it seems that there will always be a fine line between construing words to give them an unnatural meaning and re-writing the contract, the latter being (quite rightly) something outside the jurisdiction of the courts.[67] Indeed, resolving ambiguity between various possible meanings of words *as written* is one thing but deciding between various possible *un*natural meanings is something much more controversial.

## 10. The Correction of Obvious Drafting Errors

**3.40** Obvious drafting errors or 'typos' can, of course, be corrected by the court where it is clear what the correction ought to be,[68] albeit such obvious mistakes do not necessarily have to appear on the face of the contractual document.[69] Examples include: 'Landlord' being read as 'Tenant';[70] 'John WH Wilson' being read as 'Mary WH Wilson';[71] 'inconsistent' read as 'consistent';[72] and 'not' being omitted.[73]

65 *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] 1 AC 1101 (HL) at [15], per Lord Hoffmann; *Investors Compensation Scheme v West Bromwich Building Society* [1998] 1 WLR 896 (HL) at 913, per Lord Hoffmann.

66 See above.

67 See, for example, *Arnold v Britton* [2015] UKSC 36 (SC) at [110], per Lord Carnwath and *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313 (HL) at 388, per Lord Mustill.

68 See, for example, *Fitzgerald v Masters* (1956) 95 CLR 420 (HCA) at [4], per Dixon CJ; *East v Pantiles (Plant Hire) Ltd* [1982] 2 EGLR 111 (CA, Eng) at 112, per Brightman LJ; *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] 1 AC 1101 (HL) at [22]–[25] per Lord Hoffmann.

69 *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] 1 AC 1101 (HL) at [24], per Lord Hoffmann.

70 *Littman v Aspen Oil (Broking) Ltd* [2006] 2 P&CR 2 (CA, Eng).

71 *Wilson v Wilson* (1854) 5 HLC 40 (HL).

72 *Fitzgerald v Master* (1956) 95 CLR 420 (HCA).

73 *Glen's Trustees v Lancashire and Yorkshire Accident Insurance Co Ltd* (1906) 8F (Ct of Sess) 915 (CtSess, Scot).





## 11. Attempts to Exempt Liability for Fraud

**3.41** No contracting party can, as a matter of public policy, contract out of liability for its own fraud,[74] albeit it may be possible for a party to exempt itself from liability for fraud by its agent.[75] However, for attempts to exclude liability for an agent's fraud, the exemption clause must make express reference to fraud; general words of exemption will not be sufficient.[76]

## 12. Attempts to Take Advantage of Own Breach of Contract

**3.42** A contracting party wishing to be able to take advantage of its own breach of contract will be required to have used very clear wording in the contract to rebut the general presumption that neither party should be allowed to obtain a benefit from its own breach.[77]

## 13. Controlling Exemption Clauses

**3.43** Before the introduction of the Control of Exemption Clauses Ordinance (Cap 71), the Hong Kong courts had no means to strike down an unreasonable/unfair exemption clause.[78] As such, where the court considered an exemption clause to be unreasonable, it could either find a way to conclude that the clause was not properly incorporated into the contract[79] or, if that was not possible, interpret the clause in a way that would not cover the liability which it purported to exempt, by reading the clause *contra proferentem*.[80]



74 See, for example, *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] UKHL 6, [2003] 1 CLC 358 (HL) at [16], [76] and [121], per Lords Bingham, Hoffmann and Scott, respectively; *Raiffeisen Zentralbank Osterreich AG v Royal Bank of Scotland Plc* [2010] EWHC 1392 (Comm) (HCt, Eng) at [325], per Clarke J.

75 See, for example, *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] UKHL 6, [2003] 1 CLC 358 (HL) at [98] and [122], per Lords Hobhouse and Scott, respectively.

76 See, for example, *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] UKHL 6, [2003] 1 CLC 358 (HL) at [68], per Lord Hoffmann.

77 See, for example, *Alghussein Establishment v Eton College* [1988] 1 WLR 587 (HL) at 595, per Lord Jauncey and *Kensland Realty Ltd v Whale View Investment Ltd* (2001) 4 HKCFAR 381, [2002] 1 HKC 243 (CFA) at [96], per Ribeiro PJ.

78 Albeit note the scope of the Ordinance (Sch 1).

79 See, for example, *Olley v Marlborough Court Ltd* [1949] 1 KB 532 (CA, Eng).

80 See, for example, *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1982] EWCA Civ 5 (CA, Eng); *Dairy Containers Ltd v Tasman Orient Line CV (The Tasman Discoverer)* [2005] 1 WLR 215 (PC: on appeal from New Zealand) at [12], per Lord Bingham.

**3.44** Since (total) exclusion clauses have always been construed more strictly than limitation clauses,[81] a party that wishes to exclude all liability would have to use very clear wording.[82] Without such clear wording, the court is likely to assume that, given the would-be harsh result to the other party if all liability is excluded, the parties are not likely to have intended all such liability to be excluded.[83]

**EXAMPLE:**

**3.45** The following cases demonstrate how the courts have interpreted particular exemption clauses:

**Photo Production Ltd v Securicor Transport Ltd**
**[1980] AC 827 (HL)**

> Under no circumstances shall [the security company] be responsible for any injurious act or default by any employee of [the security company] unless such act or default could have been foreseen and avoided by the exercise of due diligence on the part of [the security company] as his employer.

Having found that the security company exercised the requisite due diligence in employing the employee in question, this clause was held to be clear enough to exclude the security company's liability for loss caused by an employee's deliberate acts (as well as his negligent acts).

**Darlington Futures Ltd v Delco Australia Pty Ltd**
**(1986) 161 CLR 500, (1986) 68 ALR 385 (HCA)**

> Any liability on the [broker's] part or on the part of its servants or agents for damages for or in respect of any claim arising out of or in connection with the relationship established by this agreement or any conduct under it or any orders or instructions given to the [broker] by the Client ... shall not in any event (and whether or not such liability results from or involves negligence) exceed one hundred dollars.

This clause was held to be clear enough to cover a situation where the broker in question deliberately entered into transactions, on behalf of the client, without the client's authorisation.

81 *Ailsa Craig Fishing Co Ltd v Malvern Fishing Co Ltd* [1983] 1 WLR 964 (HL) at 966, per Lord Wilberforce. Albeit such construction should not be strained where the meaning is clear.

82 See, for example, *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827 (HL) at 850 & 851, per Lord Diplock, especially in the case of large businesses that have ready-access to legal advice and insurance.

83 See, for example, *L Schuler AG v Wickman Machine Tool Sales Ltd* [1974] AC 235 (HL) at 251, per Lord Reid: the more unreasonable the result, the less likely that the parties intended it.





## 14. Attempts to Exempt Liability for Negligence

**3.46** Based on the *Canada Steamship* principles, unless negligence is *expressly* excluded in the contractual clause, the court will not interpret the exclusion clause to cover negligence unless the words used in the clause are wide enough to cover negligence and negligence is the only type of liability that the clause could be said to cover.[84] However, subsequent developments suggest that, nowadays, only lip-service is paid to the *Canada Steamship* principles such that the usual principles of contractual interpretation (construing the clause in the context of the whole contract and as against the relevant background facts) will apply when determining whether liability for negligence has been excluded.[85] Certainly, it has been noted that the *Canada Steamship* principles should not be applied mechanistically and that they do not provide an automatic solution: rather, they should be regarded as mere guidelines.[86] As such, if a party wishes to exclude liability for negligence, it should always do so expressly in order to avoid the construction challenge.[87]

## 15. Liability under Guarantees

**3.47** Contracts of guarantee have traditionally been construed strictly in favour of the guarantor such that, where there is any ambiguity, the guarantee will be interpreted *contra proferentem*, that is against the creditor as the party who seeks

84 *Canada Steamship Lines Ltd v R* [1952] AC 192 (PC: on appeal from Canada) at 208, per Lord Morton: on the facts, the clause in question was, on the face of it, wide enough to cover negligence (albeit negligence was not expressly referred to) but was, at the same time, wide enough to cover liability arising *other than* in negligence and so negligence was held to be not covered by the clause.

85 *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] UKHL 6, [2003] 1 CLC 358 (HL) at [63], per Lord Hoffmann (indeed, the court may even start by trying to ascertain whether the parties did *not* intend to exclude negligence (see at [67]). Note, however, it might be said that the language used in the *Canada Steamship* principles (ie 'the words used are wide enough, *in their ordinary meaning*, to cover negligence' (emphasis added)) are actually consistent with the modern approach to contract interpretation: see *Persimmon Homes Ltd v Ove Arup and Partners Ltd* [2015] EWHC 3573 (TCC) (HCt, Eng) at [24], per Stuart-Smith J.

86 *Mir Steel UK Ltd v Morris* [2012] EWCA Civ 1397 (CA, Eng) at [34]–[35], per Rimer LJ. Note, however, that the *Canada Steamship* principles have, more recently, seen endorsement at senior court level (albeit in a slightly edited form by omitting to make reference to the third principle): see *Societe Generale, London Branch v Geys* [2013] 2 WLR 50 (SC) at [37], per Lord Hope. Nevertheless, it is nowadays often thought that the *Canada Steamship* principles are more relevant to indemnity clauses than to exemption clauses: see, for example, *Persimmon Homes Ltd v Ove Arup & Partners Ltd* [2017] EWCA Civ 373 (CA, Eng) at [56], per Jackson LJ. For further critique of the *Canada Steamship* principles, see L Mason, 'Rethinking negligence in force majeure clauses: risk allocation, fairness and certainty in commercial contracts' (2010) JBL 199.

87 Albeit, such exclusion may still fall foul of the reasonableness test in s 3 of the Control of Exemption Clauses Ordinance (Cap 71).

Government's SARS Expert Committee on 2 October 2003 and were important to the determination of liability under the insurance policy:

- *10 February 2003*: the Hong Kong media reported an outbreak of a pneumonia-like disease in Guangdong;
- *11 February 2003*: the Guangzhou Bureau of Health confirmed this outbreak – the World Health Organisation ('WHO') announced that it had received reports from mainland Chinese authorities of an epidemic of acute respiratory syndrome, with 300 cases and five deaths in Guangdong – in Hong Kong, the Hospital Authority convened a Working Group to establish a surveillance system for cases of atypical pneumonia in public hospitals;
- *12 February 2003*: the Working Group set out procedures for *requesting* notification by public hospitals to the Department of Health of any cases of severe community-acquired pneumonia ('CAP');
- *13 February 2003*: the same request for notification was made to private hospitals;
- *22 February 2003*: a mainland Chinese visitor ('Patient AA' – the most likely source of the outbreak of SARS in Hong Kong), after arriving in Hong Kong on the previous day, was admitted to hospital;
- *4 March 2003*: Patient AA died;
- *12 March 2003*: the WHO issued a global alert notice about cases of acute respiratory syndrome in Hong Kong, Guangdong and Vietnam;
- *15 March 2003*: the WHO issued an emergency travel advisory statement, identifying the disease as 'SARS' for the first time;
- *22 March 2003*: scientists discovered the cause of SARS;
- *27 March 2003*: the Hong Kong Government added SARS to the list of infectious diseases under Schedule 1 of the QPDO (Cap 141), making it *mandatory* for SARS cases to be notified to the Government;
- *mid-April 2003*: it was confirmed that Patient AA (who had died on 4 March 2003) had died of SARS;
- *23 June 2003*: the SARS epidemic was officially declared over.

## 3. The Construction Issues

First, on the proper interpretation of the insurance policy, and on the facts set out in the Report, on what date did SARS become a 'notifiable human infectious or contagious disease' within the meaning of clause 14.5? Secondly, what was the commencement date of coverage under clause 14.5 with regard to losses resulting from SARS?

### *3.1 The court's interpretation on the first issue*

On the first issue, the Court of Final Appeal unanimously agreed with the findings of both the Court of First Instance and the Court of Appeal that 'notifiable' in clause 14.5 referred to a *legal or mandatory requirement* to notify.





#### 3.1.1 The appellants had argued:

A. Such an interpretation of 'notifiable' was too narrow and should, instead, simply include infectious or contagious diseases which were serious enough to warrant notification to the authorities, as a matter of prudence, such as the (non-mandatory) administrative scheme of *requesting* notification (introduced on 12 and 13 February 2003); and

B. Even if such a reading is not clear, the interpretation should be *contra proferentem*.

#### 3.1.2 The court's response to the first argument A:

(a) If 'notifiable' simply referred to those diseases serious enough to warrant notification, *when* would a disease be so serious as to warrant such notification? According to the court, '[t]his is a question on which medical minds might be expected to differ';[3]

(b) the administrative scheme of *requesting* notification (introduced on 12 and 13 February 2003) was inconsistent with the notion inherent in the appellants' contention (and in clause 14.5) that a 'notifiable' disease is a *serious* disease. According to the court, '[a] serious disease ... would *require* notification';[4]

(c) there was a lack of definition or description of the *class of persons* being requested (on 12 and 13 February 2003) to notify the Department of Health, other than the hospitals. According to the court, '[s]urely such a ... scheme would need to extend ... to *all* medical practitioners and carers';[5] and

(d) it was unclear, under the scheme (introduced on 12 and 13 February 2003), which *type* of case should be notified: a specific disease or the more vague concept of pneumonia-like symptoms which were characteristic of CAP. According to the court, the description of the type of case which was being requested to be reported was 'imprecise, to say the least'.[6]

#### 3.1.3 The correct interpretation: a contextual approach

The Court of Final Appeal firmly restated the correct approach to the interpretation of *all* commercial contracts:

> The interpretation which should be adopted in the case of an insurance contract, as with other commercial contracts, is that which gives effect to the context, not only of the particular provision but of the contract as a whole, consistently with the sense and purpose of the provision[...]. In arriving at the true interpretation, the court

3 At [32], per Sir Anthony Mason NPJ. Related to this point, the judge at first instance noted the potential for a 'protracted and expensive examination' if the appellants' proposed interpretation was accepted: see [2010] 2 HKLRD 744, [2010] HKCU 792 (CFI) at [41], per Reyes J.

4 At [33], per Sir Anthony Mason NPJ (emphasis in original).

5 ibid (emphasis added).

6 ibid.

> will read the words and expressions of the contract as ordinary commercial people would understand them in their context…[7]

The court then emphasised that, where there is ambiguity, the clause would be interpreted *contra proferentem*, recognising that this principle has been said to 'strongly' apply in the interpretation of insurance contracts.[8]

#### 3.1.4 The court's application of the contextual approach to the facts in this case

After surveying the various dictionary definitions of the word 'notifiable' in the context of infectious or contagious diseases, the court acknowledged that the leading dictionaries 'do not speak with a single voice'[9] as to whether such notification is a mandatory legal obligation. However, the court thought that, since the leading *medical* dictionaries attribute a *legal obligation* to the word 'notifiable' in this context, 'commercial people would look to the medical understandings and expect and intend their words to be understood accordingly'.[10] As such, the court concluded that the phrase 'notifiable human infectious or contagious disease' in the insurance policy referred to such a disease which is *required by law* to be notified to the relevant authorities. This interpretation, the court believed, is not only consistent with most dictionary definitions but also 'gives effect to the immediate context'.[11]

The court also accepted other contexts in support of its conclusion. First, it was noted that clause 14.5 provided for two causes of loss from infectious or contagious diseases: one where *any* infectious or contagious disease occurs 'on the Premises', and one where a *notifiable* infectious or contagious disease occurs 'within 25 miles of the Premises'. In light of this more stringent requirement where an infectious or contagious disease occurred *away* from the premises, the court thought that it was appropriate to give the word 'notifiable' a 'clear and certain meaning'.[12]

Secondly, it was noted that it was common knowledge that there exist statutory regimes in many jurisdictions that provide for mandatory notification of specified infectious or contagious diseases. As such, the court thought that the parties 'would have been well aware' of this and 'would have contracted with that knowledge in mind'.[13]

7 At [34], per Sir Anthony Mason NPJ. Note also that Bokhary PJ (at [2]) added similar approval to such a contextual analysis.

8 At [34], per Sir Anthony Mason NPJ. However, note that Bokhary PJ (at [2]) also emphasised that where the meaning is clear, the *contra proferentem* rule does not apply.

9 At [36], per Sir Anthony Mason NPJ.

10 At [38], per Sir Anthony Mason NPJ.

11 ibid.

12 At [39], per Sir Anthony Mason NPJ. Indeed, the judge at first instance thought that the parties were more likely to have entered into the insurance contract on the basis that there was a 'clear-cut test' for determining whether a disease was 'notifiable', '[g]iven the importance of certainty to commercial parties': see [2010] 2 HKLRD 744, [2010] HKCU 792 (CFI) at [41], per Reyes J.

13 At [40], per Sir Anthony Mason NPJ.





Accordingly, the court concluded the first issue, stating:

> It cannot be doubted that, against this background, commercial people would read the words in question as referring to infectious or contagious diseases which are *required by law* to be notified to a public authority. So read, the words in question provide a clear and certain criterion for determining whether a disease is 'notifiable'.[14] [Emphasis added]

#### 3.1.5 The court's response to the second argument B:

Since the reading was clear, and there was an absence of ambiguity, there was nothing to attract the *contra proferentem* principle as an aid to construction.[15]

### 3.2 *The second issue*

On the second issue, the Court of Final Appeal agreed with the findings of both the Court of First Instance and the Court of Appeal that the commencement date of coverage for losses resulting from SARS was 27 March 2003.

#### 3.2.1 The appellants had argued:

Since there was an absence, in clause 14.5, of any stipulation that an insured can only recover loss sustained *after* SARS became 'notifiable', the only requirement was that the loss resulted from a 'notifiable' infectious or contagious disease, which SARS *eventually* became, and that therefore any loss caused by SARS *before* it became so 'notifiable', could still be indemnified so long as it was incurred within the policy's period of coverage (that is, 1 July 2002 to 1 July 2003).

#### 3.2.2 The court's response to this argument:

The appellants' argument failed to appreciate that the cause of the loss must be a 'notifiable' infectious or contagious disease and that such a disease does not become so 'notifiable' until it is *legally required* to be notified which, as already found, was 27 March 2003. Therefore, *before* that date, any loss incurred as a result of SARS was *not* caused by a 'notifiable' disease capable of being indemnified under clause 14.5. According to the court:

> Clause 14.5 incorporates a discrete indemnity and requires effect to be given to the expression '*notifiable* human infectious or contagious disease' *according to its true interpretation*.[16] [Emphasis added]

## 4. COMMENT

This Court of Final Appeal decision makes clear that provisions in insurance contracts, as with all commercial contracts, should be construed contextually, with regard to the contract as a whole, consistent with how they would be understood by ordinary commercial men. Furthermore, commercial certainty seemed to be

14 ibid.

15 At [42], per Anthony Mason NPJ.

16 At [45], per Sir Anthony Mason NPJ.

> resolve shall be referred to arbitration before any legal proceedings are initiated. The arbitration shall be conducted in the UK in accordance with the provisions of the law in the UK in effect at the time of the arbitration and shall be conducted by one or more arbitrators appointed there under.

This is an example of very sloppy drafting. It is *contradictory*: it provides for both the exclusive jurisdiction of the courts *and* arbitration. However, the judge in this case concluded that there *was* an effective arbitration agreement.

## 2. So, how did the court interpret the contract and resolve the inconsistency?

According to the plaintiff, Articles 13 and 14 do not provide for a valid arbitration provision.

(1) ***The plaintiff argued:*** The two clauses are inconsistent and cannot be read in such a way as to reconcile them.
***The court held:*** The two clauses are not irreconcilable but, rather, can be read together. Article 13 provides for 'UK law' to be the proper law of the contract and Article 14 provides for the law of the arbitration. Read together, these Articles provide that the *curial* law (law of the seat/*lex arbitri*) is 'UK law' and the courts *supervising* the arbitration will be the 'UK courts', which will apply 'UK law', and that such courts are to have exclusive jurisdiction. In the event of the arbitration provision being or becoming in some manner ineffective, the 'UK courts' are to have exclusive jurisdiction, applying 'UK law'.

(2) ***The plaintiff argued:*** There is no such thing as 'UK law' or 'UK courts'.
***The court held:*** Based on the words of Bingham LJ in *Hellenic Steel Co v Svolamar Shipping Co Ltd (The Komninos S)*,[4] when dealing with a reference to 'British Courts', it must mean the *English* courts, specifically the High Court in London (which comprises both the Commercial Court and Admiralty Court) which has far greater experience of dealing with a wide range of international maritime business on a daily basis: no other court in the UK enjoys that reputation or dispatches that business and, as such, it is extremely unlikely that the parties intended the Scottish courts or Northern Irish courts.

(3) ***The plaintiff argued:*** There is no express provision for a venue for the arbitration.

4 [1991] 1 Lloyd's Rep 370 (CA, Eng) at 374, per Bingham LJ.





***The court held:*** Once Articles 13 and 14 are construed in accordance with his conclusions at *(1)* and *(2)* above, the venue was, and was intended to be, London. The procedural law is that of England, the supervising courts are the Courts of England and there is no need for any separate express provision for the seat or venue to be in 'London'.

(4) ***The plaintiff argued:*** The arbitration provision is not expressed to be final and binding.
***The court held:*** The parties intended that the arbitration for which they were providing *was* final and binding – and, in any event, s 58(1) of the Arbitration Act 1996 (which applies to all arbitrations governed by English law, which the judge was satisfied that this arbitration was) states that:

> Unless otherwise agreed by the parties, an award made by the tribunal pursuant to an arbitration agreement is final and binding both on the parties and any persons claiming through or under them.

## 2. Policy Reasons?

Certainly, it would seem that there are sound policy reasons behind such interpretations of arbitration clauses where, in the face of inconsistency, the court will tend to favour the upholding of even badly-drafted arbitration clauses, so as to avoid litigation in the courts and thereby promote alternative dispute resolution.

enforce the contractual term, *unless* it can be shown that, *on a proper construction* of the contract, the term was *not* intended to be enforceable by that third party.[10]

## 3. How is the Presumption Rebutted?

Using the ordinary (objective) principles of contractual interpretation, rebutting the presumption can be achieved in either of two ways:

### *3.1 There is an express term clearly precluding third party enforceability*

For example:

> A person who is not party to this agreement shall have no right under the Contracts (Rights of Third Parties) Ordinance (Cap 623) to enforce any of its terms [except and to the extent that this agreement expressly provides for such Ordinance to apply to any of its terms].

### *3.2 There is a term which is inconsistent with the contracting parties' intention to confer a right of enforceability on the third party*

For example, where, despite there being a term dealing with the assignment of a benefit to a third party, there also exists a term *prohibiting* one contracting party from assigning that benefit without the consent of the other contracting party.

## 4. Some Guidance from English Case Law

Given that the Ordinance is fairly young, there is currently no (or no significant) Hong Kong case law available for guidance as to how the Ordinance works in practice. However, given that the Ordinance is largely modelled on the UK's Contracts (Rights of Third Parties) Act 1999 ('the UK Act'), it is apposite to consider some English case law relevant to the UK Act so as to provide guidance as to how a Hong Kong court is likely to apply the Ordinance.

- **A is a hedge-trimmer. B owns land adjoining C's land. B employs A to trim B's hedge which adjoins C's land. Does the A–B contract *purport* to confer a benefit on C, thereby giving rise to a rebuttable presumption of a right to C to enforce the A–B contract?**

No. In this case, the A–B contract only confers a *consequential* or *incidental* benefit on C. The presumption will only arise where the contract term purports to confer a benefit on the third party *directly*.[11]

10 Section 4(3). This sub-section is therefore capable of disapplying s 4(1)(b).

11 *Dolphin Maritime & Aviation Services Ltd v Sveriges Angfartygs Assurans Forening* [2009] EWHC 716 (Comm) (HCt, Eng) at [74]–[77], per Clarke J.





- **Does the benefit to be conferred on the third party have to be the *predominant* intention behind the contractual term?**

No. So long as the benefit to be conferred on the third party at least appears to be intended to *some* degree.[12]

- **Is *silence* enough to rebut the presumption?**

No. It would have to be *proven* that the term was not intended to be enforced by the third party.[13]

- **Is an *existing right* to enforce enough to rebut the presumption (for example, an existing right via a trust in favour of the third party)?**

No. This is not sufficient to establish that the contracting parties intended to *exclude* a right of enforcement under the Ordinance.[14]

## 5. Example: Revisiting a Leading Case on Privity

As an example of how the Ordinance may enable a third party to have a contractual right of enforcement without such right being expressly conferred on him, it will be useful to revisit a leading case concerning the doctrine of privity and consider how that fact pattern might be dealt with under the Ordinance.

**Beswick v Beswick**
**[1968] AC 58 (HL)**

In this case, an uncle sold his coal-delivery business to his nephew in return for a promise that the nephew would pay a specified weekly sum to the uncle for the rest of the uncle's life and, thereafter, a specified weekly sum to the uncle's 'widow'. After the uncle's death, the nephew only made one payment of the specified sum to the widow and refused to make further payments. Therefore, the widow brought an action for specific performance to compel the nephew to continue making payments to her. The UK House of Lords rejected the claim brought in the widow's *personal* capacity on the grounds of her not being privy to the agreement between the uncle and the nephew but, nevertheless, avoided an unjust result by allowing her claim brought in the capacity as *administratrix* of her late-husband's estate.

12 *Prudential Assurance Co Ltd v Ayres* [2007] EWHC 775 (Ch) (HCt, Eng) at [28], per Lindsay J.

13 *Nisshin Shipping Co Ltd v Cleaves & Co Ltd* [2003] EWHC 2602 (Comm) (HCt, Eng) at [23], per Colman J.

14 ibid at [30]–[31].