Law of Contract in Hong Kong

Cases and Commentary

Revised Second Edition

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With a foreword by

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It is not the case, however, that there is any magic formula of words which will always be effective to preclude contractual force being given to pre-contractual statements. Every case must be assessed having regard to the language employed and each particular matrix of facts in order to establish objectively the parties' contractual intention.

8.5 Interpretation of Terms

(a) General principles of interpretation

Among the most frequently occurring problems involving contracts is their interpretation. Terms are often expressed in such a way that their meaning is vague or open to more than one reasonable interpretation. Where the vagueness or ambiguity affects an essential term and cannot be resolved, it will render the agreement contractually void, especially if the agreement has not been partly performed.[92] In other cases, it is necessary to find a way to resolve the vagueness or ambiguity in order that the contract may be performed according to its terms or so that a dispute may be resolved.

In the common law tradition, the sole object of interpreting a contract is to discover the intention of the parties.[93] Although the object is constant, the manner of its achievement has changed over time. In the 19th and early 20th centuries, when the influence of legal positivism in England was at its zenith, the predominant approach was to search for the parties' intentions exclusively by reference to the contractual language they chose to employ. This approach was clearly articulated by Cozens-Hardy MR in *Lovell and Christmas Ltd v Wall*:[94]

> 'If there is one principle more clearly established than another in English law it is surely this: It is for the court to construe a written document. It is irrelevant and improper to ask what the parties, prior to the execution of the instrument, intended or understood. What is the meaning of the language that they have used therein? That is the problem, and the only problem. In saying that, I do not mean to assert that no evidence can be admitted. Indeed, the contrary is clear. If a deed relates to Black Acre, you may have evidence to show what are the parcels. If a document is in a foreign language, you may have an interpreter. If it contains technical terms, an expert may explain them. If, according to the custom of a trade or the usage of the market, a word has acquired a secondary meaning, evidence may be given to prove it. … But unless the case can be brought within some or one of these exceptions, it is the duty of the court, which is presumed to understand the English language, to construe the document according to the ordinary grammatical meaning of the words used

92 See chapter 4.
93 *Marquis of Cholmondeley v Clinton* (1820) 2 Jac & W 1.
94 (1911) 104 LT 85 at 88, 27 TLR 236.

> therein, and without reference to anything which has previously passed between the parties to it.'

That the parties' contractual intentions were to be discovered almost exclusively within the four corners of the written contractual document was often called, unsurprisingly, the 'four corners rule'. However, over the course of the 20th century the common law began gradually to rely less on this rule. By 1971, Lord Wilberforce was able to say in *Prenn v Simmons*:[95]

> 'The time has long passed when agreements, even those under seal, were isolated from the matrix of facts in which they were set and interpreted purely on internal linguistic considerations. ... We must ... enquire beyond the language and see what the circumstances were with reference to which the words were used, and the object, appearing from those circumstances, which the person using them had in view.'

Similarly, the Privy Council remarked in *Mitsui Construction Co Ltd v Attorney General of Hong Kong*:[96]

> 'It is obvious that this is a badly drafted contract. This, of course, affords no reason to depart from the fundamental rule of construction of contractual documents that the intention of the parties must be ascertained from the language they have used interpreted in the light of the relevant factual situation in which the contract was made. But the poorer the quality of the drafting, the less willing any court should be to be driven by semantic niceties to attribute to the parties an improbable and unbusinesslike intention, if the language used, whatever it may lack in precision, is reasonably capable of an interpretation which attributes to the parties an intention to make provision for contingencies inherent in the work contracted for on a sensible and businesslike basis.'

The requirements of the more contextual approach to contract interpretation were articulated by Lord Hoffmann (now Lord Hoffmann NPJ of the Court of Final Appeal) in the following highly influential passage from *Investors Compensation Scheme Ltd v West Bromwich Building Society (No 1)*:[97]

> 'I think I should preface my explanation of my reasons with some general remarks about the principles by which contractual documents are nowadays construed. I do not think that the fundamental change which has overtaken this branch of the law, particularly as a result of the speeches of Lord Wilberforce in *Prenn v Simmonds* [1971] 1 WLR 1381 at 1384–1386 and *Reardon Smith Line Ltd v Hansen-Tangen, Hansen-Tangen v Sanko Steamship Co* [1976] 1 WLR 989, is always sufficiently appreciated. The result has been, subject to one important exception, to assimilate the way in which such documents are interpreted by judges to the common sense principles by which any serious utterance would be interpreted in ordinary life. Almost all the old intellectual

95 [1971] 3 All ER 237 at 239–240.

96 [1987] 1 HKC 31 at 39, [1987] HKLR 1076 at 1082 (PC on appeal from Hong Kong).

97 [1998] 1 All ER 98 at 114-115, [1998] 1 WLR 896 at 912–913.

baggage of "legal" interpretation has been discarded. The principles may be summarised as follows.

(1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.

(2) The background was famously referred to by Lord Wilberforce as the "matrix of fact", but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.

(3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear. But this is not the occasion on which to explore them.

(4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax (see *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] 2 WLR 945).

(5) The "rule" that words should be given their "natural and ordinary meaning" reflects the commonsense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had. Lord Diplock made this point more vigorously when he said in *Antaios Cia Naviera SA v Salen Rederierna AB, The Antaios*, [1985] AC 191 at 201: "... if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business common sense, it must be made to yield to business common sense."'

Therefore, where the words employed in an agreement are reasonably open to more than one interpretation, resort may be had to the circumstances surrounding its conclusion – its 'matrix of fact' - in order to ascertain objectively the parties' true intention. It is to be noted, however, that an agreement's 'matrix of fact' does not include the parties' pre-contractual

negotiations. Nevertheless, ample scope remains for a court to receive and evaluate evidence indicating the parties' objectives in concluding the contract for the purpose of resolving any ambiguity in its terms.

Gladson China Ltd v Lam Chun June
Court of Appeal
[2001] 1 HKC 318; [2001] 2 HKLRD 235

In March 1994, Lam owned a house and garden at Hong Lok Yuen which Gladson China Ltd agreed to purchase for more than $12m pursuant to a provisional sale and purchase agreement. Clause 34 of the agreement provided in part as follows: *'... the Vendor warrants or represents that each and every fixture, fitting, erection, structure and building works on the Premises or any part or parts thereof is erected in all respects in compliance with the Building Ordinance and/or its subsidiary legislation and/ or any other legislation or regulation. The Vendor shall be liable if it is discovered before completion of this sale and purchase that the present use of the Premises or any part or parts thereof is not a permitted user or that at the date hereof or before completion, there is any erection, structure, fittings, fixture and/or buildings works (if any) in any part or parts of the Premises which is in contravention of the Building Ordinance and its subsidiary legislation and/or other legislation or regulation, the Vendor shall be held responsible for the demolition, alteration, removal, reinstatement, reinforcement and/or any other works relating to such illegal erection, structure, fixture, fittings and/ or building works (if any) or for any costs and expenses of and incidental thereto whether or not such works are required by the Building Authority or other authority or body or otherwise. The Purchaser shall be entitled to rescind this Agreement.'* The house included a small porch which had not been approved by the Building Authority as required by law. At inspection, Gladson China became aware that the porch might not have been built with the necessary approvals required by law, and therefore caused cl 34 to be included in the contract. They also caused cl 12 to be included: *'As regards the additional structures erected on the ... property the owner shall produce evidence showing the legality of such structure'*. Gladson China did not raise a requisition on the porch within the period prescribed by the contract, but became definitely aware of the unauthorised status of the porch shortly before settlement in August 1995 when Lam's solicitors asked Gladson China what they would like Lam to do about it. This instigated a volley of correspondence at the end of which Gladson China purported to rescind the agreement and claimed the return of its deposit pursuant to cl 34. Lam counterclaimed damages for loss of the bargain. Gladson China succeeded at trial, and Lam appealed.

Stock JA: ... The sole issue, as the learned judge at first instance rightly said, was whether the plaintiff was entitled to rescind the formal agreement because the entrance porch extension was not approved by the Building Authority. ... The judge commented that the porch was but a very minor part of the property. The property as a whole enjoyed a gross floor area of about 2,150 sq ft, and a garden of 2,800 sq ft. He took the view that the dispute about the porch related to a trivial matter. The porch could easily have been demolished