

Case Bulletin: 2020/06

Principles of Contractual Interpretation and Admissibility of Evidence

One of the attractions of English law as a legal system of choice in commercial matters is its stability and continuity, particularly in contractual interpretation¹. However, not everyone will be pleased, as there is always two sides of the same coin. *Da Shing Group Limited v Nicerich Promise Limited* [2020] HKCFI 588 reminds us that the absence of an express provision is a weighty indication in the interpretation of a contract, and may give rise to expensive litigation with hairsplitting arguments.

I. Background

1. The Plaintiff deposited a sum of HK\$30 million into the Defendant's designated bank account pursuant to a contract written in Chinese in relation to the prospective sale and purchase of shares in a listed company.
2. The contract was not prepared by lawyers and it expressly states that only some of its terms are legally binding. Clause 5 provides for the deposit and its treatment as part payment of the purchase price if and when a formal agreement for sale and purchase is entered into. However, there is no express provision stating whether the money is refundable when the negotiation fell through.
3. Dispute arose between the parties, and it was necessary for the Court to examine Clause 5 and the wider relevant factual matrix in determining who is entitled to keep the money in light of the parties' rival interpretations of the contract.

¹ By Lord Hodge in *Wood v Capital Insurance Services Ltd* [2017] AC 1173 at 1179.

4. The Defendant produced three drafts of the contract and sought to rely on them, in particular, a version that contained the words “可退回” (literally translated as “may be refunded”) and the proviso concerning the mechanism and time for the money to be repaid, which were deleted by the Defendant. It appears from the judgment that this particular draft was sent to the Defendant’s witness from a friend of his, rather than the Plaintiff.
5. Furthermore, the Defendant presented some commercially sound arguments including *inter alia* that there would be no monetary consideration provided by the Plaintiff for the obligations assumed by the Defendant, such as the right to exclusive negotiation, the right to assistance and information from the Defendant during the Plaintiff’s due diligence exercise, and therefore was not refundable. The Plaintiff was a complete stranger to the Defendant, and disclosure to a complete stranger of the Listco’s confidential information entails very significant risks. Accordingly, it was more likely that the money was intended to be monetary consideration for the Defendant’s obligations in the contract.

II. Key Points

1. The general principles of contractual interpretation is not controversial. In considering the language (text) and the commercial background or factual matrix (context), the following guiding principles were extracted from the leading authorities:
 - (a) When interpreting a written contract, the Court is concerned to identify the intention of the parties by reference to “what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean”.
 - (b) The meaning has to be assessed in the light of (i) the natural and ordinary meaning of the clause, (ii) any other relevant provisions of the contract, (iii) the overall purpose of the clause and the contract, (iv) the facts and circumstances known or assumed by the parties at the time that the contract was executed, and (v) commercial common sense, but (vi) disregarding subjective evidence of any party’s intentions.

- (c) The Court can give weight to the implications of rival constructions by reaching a view as to which construction is more consistent with business common sense, but it must also be alive to the possibility that one side may have agreed to something which with hindsight did not serve his interest. Similarly, the Court must not lose sight of the possibility that a provision may be a negotiated compromise or that the negotiators were not able to agree more precise terms.
 - (d) It does not matter whether the more detailed analysis commences with the factual background and the implications of rival constructions or a closer examination of the relevant language in the contract, so long as the Court balances the indications given by each.
2. A judge will determine the questions in light of the credibility of the witnesses and deal with any disputed factual evidence. Some of the guiding principles in determining the admissibility of evidence can be found in this case:
- (a) Save in exceptional circumstances, pre-contract negotiations are generally not admissible, because *inter alia* in a world of give and take, the parties often have to be satisfied with less than they want, and it may be the only way to get 'agreement' and in the hope that dispute will not arise. The reasons or justifications for the parties to agree to amendments could very often be multiple. It would be dangerous to admit evidence of either party's objective or intent, even if this is known to the other party. It would be wholly speculative, hence unsafe and unhelpful, to make any finding of common intention out of such evidence from the parties.
 - (b) In other words, pre-contractual exchanges are excluded as evidence because they are irrelevant to the question to be decided by the Court, namely, what the parties would reasonably be taken to have meant by the language which they finally adopted to express their agreement.
 - (c) Even if they are admitted in exceptional cases, they are admitted not as evidence of what the clause in question means, but as "background known to the parties" that may assist the interpretation.
 - (d) It is in the course of ascertaining the presumed intention, which constitutes

part of the background or surrounding circumstances, that the evidence is admitted in order to assist in the interpretation of the contract, when its language is ambiguous or susceptible of more than one meaning. This is the fundamental premise for admitting evidence as factual matrix in aid of contract interpretation.

(e) Subsequent conduct and statement of the parties after the contract has been entered are generally not relevant and not admissible.

3. Consideration needs not be monetary to be sufficient in law.

III. Findings

1. The Judge preferred the Plaintiff's evidence, and found the provision in relation to the deposit of money was a negotiated compromise, a product of give and take, and the parties were unable to agree at more precise terms.
2. The evidence of pre-contract negotiation in relation to the amendments made is not admissible.
3. There is nothing in the contract suggesting that the money is not refundable if the negotiation fell through, or the money was paid in consideration of the rights granted to the Plaintiff.
4. In performance of the contract, the Plaintiff would have *inter alia* incurred substantial costs and expenses in the due diligence as well as the negotiation of the terms of the formal agreement, and constituted sufficient consideration moved from the Plaintiff.
5. Similar to the word "deposit", there is no definite meaning of "定金" under Hong Kong law as to whether it is refundable.
6. In the circumstances, the Judge found *inter alia* that:
 - (a) The money is a significant sum, and if the mutual intention of the parties was to treat it as the price for the Defendant's obligations under the contract, it is more likely that the parties should expressly spell this out in

the contract.

- (b) There is no sufficient evidence to show that objectively, the Plaintiff at the time of the contract would be so keen to the extent to pay HK\$30 million just for the exclusive opportunity to negotiate and nothing else.
 - (c) At any time during the negotiation, the Defendant could decide to take the money and let the negotiation fall through. It would be too easy for the Defendant to abandon the negotiation and keep the money without any need to account to the Plaintiff for anything. No reasonable person having knowledge of the commercial context of the contract and the commercial purpose of the deposit would have understood the parties to have agreed that the money would be retained by the Defendant whether or not the intended deal would proceed.
7. In conclusion, having consideration the contract and the relevant commercial background, the Judge found that the nature of the deposit was no more than earnest money to demonstrate the Plaintiff's sincerity in entering into the negotiation with the Defendant. The Defendant was ordered to pay the sum of HK\$30 million and costs to the Plaintiff.

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