JANUARY 2014

INTERPRETING A COMMERCIAL CONTRACT—HOW FAR CAN THE HONG KONG COURTS GO?

In a recent decision of the Hong Kong Court of Final Appeal ("CFA") in *Sinoearn International Limited v Hyundai–CCECC Joint Venture (a firm)* (FACV No.22 of 2012, September 30, 2013) (the "Decision"), the CFA was asked to revisit a widely discussed point of contract law: the extent to which the courts can consider the commercial purpose of the parties when interpreting a commercial contract. It is an area of law which has stirred a flurry of commentary from academics and commercial law practitioners from many common law jurisdictions and one which has now finally been addressed before Hong Kong's highest court.

SUMMARY OF FACTS

The Decision concerned a dispute over the interpretation of an agreement made between the parties in July 2000 (the "Agreement"). Under the Agreement, Sinoearn International Limited (the "Respondent") agreed to act as the agent of Hyundai–CCECC Joint Venture (a firm) (the "Appellant") to obtain dumping permits from the Mainland Chinese authorities to enable contaminated mud dredged in Hong Kong waters, as part of the Container Terminal 9 ("CT9") development project, to be dumped in Mainland Chinese waters at a dumping ground in South Erzhou, China ("SEZ (China)").

In accordance with the Agreement, the Appellant had the obligation to pay the Respondent for obtaining the dumping permits, and it was common ground that the payment was stipulated in the Agreement as HK$17 per m^3. However, due to unforeseen circumstances, the Appellant was unable to dump at SEZ (China), and a dispute ensued as to whether or not the Appellant was under an obligation to dump a minimum quantity of contaminated mud at SEZ (China) and/or make payment to the Respondent for such minimum quantity.

Accordingly, the key issues in this case concerned the interpretation of the Appellant's dumping and payment obligations under the Agreement.

THE MUDDLE BELOW

When the issue was brought before the courts, the Court of First Instance[1] ("CFI") held that the Appellant was not under an obligation to dump (or pay for) a minimum quantity of contaminated mud at SEZ (China). Thus, the Respondent's entitlement to payment under the Agreement was HK$17 per m^3 of contaminated mud *actually disposed* of by the Appellant at SEZ (China).

The Court of Appeal[2] ("CA"), however, viewed the contract in a completely different light and set aside the CFI judgment. The CA ruled that the Appellant had agreed to pay the Respondent to secure the right to dump the *entire amount* of contaminated mud dredged in SEZ (China).

Both courts had spent a great deal of time trying to decipher the contract before them by giving due consideration to the commercial purpose of the parties, and it was this latter issue that came before the CFA.

Case law demonstrates that there are limits to the extent to which the courts' perception of commercial purpose can be used to interpret a contract. However, the Appellant appealed to the CFA on the basis that the CA had gone beyond those limits in its judgment: the CA had placed too much emphasis on what it perceived to be the commercial purpose of the parties when interpreting the Respondent's entitlement to payment under the Agreement. The question is then, of course, one of balance. How far can the courts go?

COMMENTARY

When a court is approached with any question of construction, it will begin its analysis by looking at the words that the parties have used in the contract. If the language is not clear, the court will conduct an assessment of the parties' intentions based on an objective test that, as Lord Hoffman famously stated in *Investors Compensation Scheme Ltd v West Bromwich Building Society*,[3] would be made according to the interpretation of 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," as applied in *Chartbrook Ltd v Persimmon Homes Ltd*.[4] This approach has been adopted across common law jurisdictions, including Australia[5] and Hong Kong.[6]

In the case of contracts between commercial parties, the words of a contract must be interpreted in the way in which a reasonable commercial person would construe them.[7] The court must always give effect to the language of the contract, especially when the words are unambiguous and commercially sensible. This principle was neatly summarized by Mortimer NPJ in *Marble Holding Limited v Yatin Development Limited*,[8] where he stated that "if the words used are free of ambiguity and devoid of commercial absurdity their natural and ordinary meaning will apply unless the relevant surrounding circumstances demonstrate otherwise. Of course, parties often fail to express themselves well or clearly in which case the surrounding circumstances are of particular value." Difficulty, of course, arises when the language in the contract is not particularly clear and the courts are forced to look at the surrounding circumstances to assist with the interpretation. However the courts must tread lightly when considering commercial purpose so as to avoid forcing a meaning upon a contract that differs from the words used by the parties. This goes to the heart of contract law.

Limits to "Commercial Purpose." The courts do not have an unfettered discretion when taking into account the commercial purpose of a contract to interpret its terms, as evidenced by the wealth of case law from common law jurisdictions, and its limitations can be distilled into three fundamental principles.

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1 *Sinoearn International Limited v Hyundai–CCECC Joint Venture* (HCA 3987/2003, April 18, 2011).
2 *Sinoearn International Limited v Hyundai–CCECC Joint Venture* (CACV 83/2011, December 23, 2011).
3 [1998] 1 WLR 896.
4 [2009] 1 AC 1101.
5 *Alstom Ltd v Yokogawa Australia Pty Ltd & Anoy (No.7)* [2012] SASC 49, §117.
6 *Ying Ho Company Limited (and others) v The Secretary for Justice* [2004] 7 HKCFAR 333.
7 *Mannai Co. Ltd. v Eagle Star Life Assurance Co. Ltd* [1997] AC 749.
8 [2008] 11 HKCFAR 222, §20.

The first is that commercial purpose must be viewed from the perspective of both parties[9] as it forms part of the factual matrix which the courts will consider when analyzing the construction of the contract.

Secondly, the commercial purpose of a contract is often mistakenly equated with the commercial expectation of the parties, which, simply put, looks to what the parties *hoped* would happen as a result of the commercial arrangement as opposed to what was actually bargained for. Courts should not look to commercial expectation because it draws upon the subjective intentions of the parties and therefore conflicts with the common law principle that contracts are to be construed objectively.[10]

Finally, the court must exercise caution before concluding that a particular interpretation does not accord with commercial sense or, as Neuberger L.J plainly put it in *Skanska Rashleigh Weatherfoil v Somerfield Stores Ltd.*,[11] "the surrounding circumstances and commercial common sense do not represent a licence to the court to re-write a contract merely because its terms seem somewhat unexpected, a little unreasonable, or not commercially very wise." The court is entitled to consider commercial common sense and choose the most sensible construction of a contract,[12] but what it cannot do is impose a commercial bargain that was not originally agreed between the parties themselves.[13]

THE DECISION

As to the issue of the limits of commercial purpose, for which leave to appeal was given, the CFA acknowledged that there was little dispute between the parties on the law governing construction and therefore reaffirmed the common law position stated above.

The CFA ruled that there was no question as to the purpose of the contract, as it was clear to the court that the parties had entered into the arrangement so that contaminated mud from CT9 could be dumped in SEZ (China). However, this commercial purpose did not materialize into the *assumption* that the Appellant would be fully liable under the contract if the dumping in Mainland waters did not take place as the parties would have contracted on that basis if that were the case. They in fact did not.

Although it was unfortunate that the Respondent was put into a disadvantageous position because of the resulting circumstances, there was "no relevant commercial common sense which would enable the court to override the language used,"[14] nor was there any support in the contractual documents to substantiate the CA's conclusion.

CONCLUSION

The Decision emphasizes the court's recognition of its role in commercial disputes. Whilst acknowledging that parties may not always fully consider the consequences of the contractual arrangements they make, it is not for the court to blindly interpret what it believes to be the most commercially sensible outcome. The courts must always look to the words of the contract, regardless of how painstakingly unfair they may be.

Jones Day was legal adviser for the Appellant before the Court of Final Appeal.

9 *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd* [1990] Q.B. 818 at 870E.
10 *Re Golden Key Ltd* [2009] EWCA Civ 636.
11 [2006] EWCA Civ 1732, §21.
12 *Rainy Sky SA and other v Kookmin Bank* [2011] UKSC50.
13 *City Alliance Ltd v Oxford Forecasting Services Ltd* [2001] 1 All E.R. (Comm) 233, CA.
14 Decision, per Mr Justice Tang PJ, §79.

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