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JUDICIAL INTERPRETATION OF COMMERCIAL CONTRACTS

This Article seeks to summarize the general approach taken by Courts while interpreting commercial contracts.

What is a Contract?

'Contract' has been defined as "an agreement between two or more persons intended to create a legal obligation between them and to be legally enforceable".[1] A contract consists of an actionable promise or promises and every such promise involves two parties, a promisor and a promisee, and an expression of a common intention and expectation as to the act or forbearance promised".[2] In Halsbury's Laws of England, Vol. VII, 2nd edition, 'contract' means an agreement made between two or more persons which is intended to be enforceable at law and is constituted by acceptance of one party of an offer made to him by the other party to do or to abstain from doing some act. The offer and acceptance may either be express or inferred by implication from the conduct to the parties. An offer when accepted is called a promise and the term denotes the legal obligation which is thereby created, on the one part to perform the promise and the other to accept performance of it.

Section 2(h) of the Indian Contract Act, 1872 has given a short but exhaustive definition of the word contract. It defines contract as "an agreement enforceable by law". The word "agreement" has been defined in section 2(e) in the following words: "Every promise and every set of promises, forming consideration for each other, is an agreement". According to section 2(b), "when the person to whom the proposal is made signifies his assent thereto the proposal is said to be accepted. A proposal, when accepted, becomes a promise".

Thus, a 'contract' is a bilateral transaction between two or more parties. Every contract goes through several stages beginning with the stage of negotiations during which the parties discuss and negotiate proposals and counter proposals as also the consideration, resulting finally in the acceptance of the proposals. It is not necessary that every contract must be in writing. There can be an equally binding contract between the parties on the basis of oral agreement unless the law requires the agreement to be in writing.

An agreement to become a contract or to be enforceable by law must fulfil the conditions laid down in section 10 of Indian Contract Act, which are as follows: (i) parties must be competent to contract; (ii) there must be free consent of the parties; (iii) there must be some consideration; (iv) the object of consideration must be lawful; (v) the agreement must not have been expressly

[1] David M. Walker Oxford Companion to Law, 1980 Ed. p. 284.
[2] Anson's Law of Contract, 23rd Edition, by A.G. Guest, 1971, p. 23.

declared to be void under the Contract Act or any other Act; and (vi) in some cases, as provided by law, the agreement should be in writing or in the presence of witnesses or be registered.

Need for Interpretation of Contracts:

Interpretation of a contract is required when the words in the contract are ambiguous i.e. they have two or more possible meanings. In such situations, the courts must prefer one meaning above the others using settled principles of interpretation. The fundamental rule of construction of a contractual document is that the intention of the parties must be ascertained from the language used by the parties, interpreted in light of the appropriate factual situation in which the contract was made.

General Rules of Interpretation of Commercial Contracts:

There are two possible approaches that can be taken while interpreting a Contract viz. the textualist approach and the contextualist approach. Textualist theorists believe that most parties prefer textualist rules of interpretation, under which the contract interpreter must normally consider only the contract's written text. In contrast, contextualist theorists believe that most parties prefer contextualist rules of interpretation, under which the interpreter should consider all relevant contextual evidence to interpret the contract, beyond the written text.[3]

While interpreting contracts, the Courts start by giving precedence to the textualist approach by trying to discern the ordinary/natural and/or plain/literal meaning of the terms. If this approach leads to ambiguity, absurdity or inconsistency with the contract, then the Court's set these against the background and/or commercial context to discern what the intention of the parties was when they entered into the contract. Moreover, the Courts also take the aid of tools of statutory interpretation to give meaning to the terms in a contract.

The primary goal in interpreting contracts is to determine and enforce the party's intent gathered from the terms of the contract. This principle affirms that contractual obligations are chosen obligations. Parties acquire them by voluntarily entering into agreements whose terms they control. Contract interpretation therefore begins by seeking out the choices parties made. Contract law gives parties the power to undertake new legal obligations when and as they wish. That power requires giving parties the obligations they intend. Hence, this principle serves to allocate responsibility. When a court enforces a contract, it is not imposing an obligation on a party, but merely giving effect to the parties own earlier choice. If a party is now unhappy with the contract terms, they have only their earlier self to blame.[4] This principle was reiterated by the Hon'ble Supreme Court of India in ***State of Gujarat v. Variety Body Builders***[5], wherein it was held that - when there is a written contract, it will be necessary for the court to find out the intention of the parties and that the intention of the parties has to be primarily gathered from the terms and conditions which are agreed upon by the parties.

In ***Ramana Dayaram Shetty v. International Airport Authority of India & Ors.***[6], the Hon'ble Apex Court held that – "…..It is a well settled rule of interpretation applicable alike to

[3] Benoliel, U., 2017. The Interpretation of Commercial Contracts: An Empirical Study. *SSRN Electronic Journal*.
[4] Klass, G., 2018. Interpretation and Construction in Contract Law. *SSRN Electronic Journal*
[5] 1976 AIR 2108
[6] AIR 1979 SC 1628

documents as to statutes that, save for compelling necessity, the Court should not be prompt to ascribe superfluity to the language of a document and should be rather at the outset inclined to suppose every word intended to have some effect or be of some use. To reject words as insensible should be the last resort of judicial interpretation for it is an elementary rule based on common sense that no author of a formal document intended to be acted upon by the others should be presumed to use words without a meaning. The court must, as far as possible, avoid a construction which would render the words used by the author of the document meaningless and futile or reduce to silence any part of the document and make it altogether inapplicable..."

In ***Bihar State Electricity Board, Patna and Ors. v. Green Rubber Industries and Ors.***[7], the Hon'ble Apex Court held that – "---Every contract is to be considered with reference to its object and the whole of its terms and accordingly the whole context must be considered in endeavouring to collect the intention of the parties, even though the immediate object of enquiry is the meaning of an isolated clause…"

It is also a well-recognized principle of construction of a contract that it must be read as a whole in order to ascertain the true meaning of its several clauses and the words of each clause should be interpreted so as to bring them into harmony with the other provisions if that interpretation does no violence to the meaning of which they are naturally susceptible.[8]

Another principle applied by the Courts is that of '***Verba chartarum fortius accipinntur contra proferentem'***, which means that ambiguous words in a written document are construed more forcibly against the party which used them. Applying this principle, the Hon'ble Apex Court in ***Bank of India and Ors. v. K. Mohandas and Ors***[9] held that – "..The fundamental position is that it is the banks who were responsible for formulation of the terms in the contractual scheme that the optees of voluntary retirement under that scheme will be eligible to pension under Pension Regulations, 1995, and, therefore, they bear the risk of lack of clarity, if any. It is a well-known principle of construction of contract that if the terms applied by one party are unclear, an interpretation against that party is preferred."

The Courts also rely on the following tools of interpretation, if there is ambiguity with respect to any terms in a contract:

1. ***Expressio unius est exclusive alterius*****,** which means that where an express intention has been made in the instrument in respect of a certain thing, this will exclude any other thing of a similar nature. For example – In ***Swastik Gases Pvt. Ltd. v. Indian Oil Corporation Ltd.***[10], it was held that by making a provision that the agreement is subject to the jurisdiction of the courts at Kolkata, the parties have impliedly excluded the jurisdiction of other courts. Hence, it was held that where the contract specifies the jurisdiction of the courts at a particular place and such courts have jurisdiction to deal with the matter, an inference may be drawn that parties intended to exclude all other courts.

2. ***Ejusdem Generis***, which means that where a class or genus of words/things is followed by general wording that is not itself expansive, the general wording is usually restricted to the

[7] AIR 1990 SC 699
[8] The North Eastern Railway Company v. L. Hastings) 1900 AC 260
[9] (2009) 5 SCC 313
[10] (2013) 9 SCC 32

class or genus of the words/things preceding it. For example, in ***M/s. Siddheshwari Cotton Mills Pvt. Ltd. v. Union of India***[11], the Supreme Court observed that the expressions 'bleaching, mercerizing, dyeing, printing, water-proofing, rubberising, shrink-proofing, organdie processing', which precede the expression 'or any other process', in Section. 2(f)(v) of the Central Excises and Salt Act 1944, contemplate processes which import a change of a lasting character to the fabric by either the addition of some chemical into the fabric or otherwise. Hence, the term 'or any other process' was interpreted ejusdem generis to the preceding words.

3. ***Noscitur a Socii***, which means that the meaning of an unclear or ambiguous word should be determined by considering the words immediately surrounding it. For example - in the case of ***Commissioner of Income Tax v. Bharti Cellular***[12], it was held that since the term 'technical services' used in section 194J of the Income Tax Act is unclear, the said word would take colour from the words 'managerial' & 'consultancy' between which it is sandwiched. These terms 'managerial services' & 'consultancy services' necessarily involve a human intervention. Therefore, applying *noscitur a sociis,* the word 'technical' would also have to be construed as involving a human element. Thus, it was held that since interconnection & port access services rendered by the assessee do not involve any human interface, they cannot be regarded as technical services u/s 194J of the Income Tax Act.

4. ***Reddendo Singula Singulis***, which means that where there are general words of description, following an enumeration of particular things, such general words are to be construed distributively and if the general words will apply to some things and not to others, the general words are to be applied to those things to which they will, and not to those to which they will not apply. For example - The term 'I devise and bequeath all my real and personal property to A' will be construed reddendo singula singulis by applying 'devise' to 'real' property and 'bequeath' to 'personal' property.

Kindly note that the abovementioned principles are non-exhaustive and the Courts can use other well-settled tools of interpretation to discern the meaning of terms used in a contract, bearing in mind the intention of the parties.

Implied Terms:

In certain kinds of contract, such as employment, consumer and landlord and tenant agreements, certain standard terms are implied by legislation and/or common law. In appropriate cases the court will recognise standard practice in those trades or areas of industry and is willing to imply terms into an agreement to reflect this practice, provided the wording of the contract is not inconsistent with the implication. Finally, if it can be shown that the parties have consistently and clearly dealt with each other on a particular basis, the court may be prepared to imply terms to reflect this, provided the actual wording of the contract does not contradict this.

However, in commercial contracts apart from the ones mentioned above, the Courts tread carefully before implying any terms into the contract. The Hon'ble Apex Court in ***Khardah***

[11] 1989 (21) ECR 7 (SC)
[12] (2014) 6 SCC 401

Company Ltd. v. Raymon and Co. (India) Private Ltd.[13] held that – " We agree that when a contract has been reduced to writing we must look only to that writing for ascertaining the terms of the agreement between the parties but it does not follow from this that it is only what is set out expressly and in so many words in the document that can constitute a term of the contract between the parties. If on a reading of the document as a whole, it can fairly be deduced from the words actually used therein that the parties had agreed on a particular term, there is nothing in law which prevents them from setting up that term. The terms of a contract can be expressed or implied from what has been expressed. It is in the ultimate analysis a question of construction of the contract and it is well established that in construing a contract it would be legitimate to take into account surrounding circumstances..."

Hence, the Court does reserve its discretion to imply terms into a contract in order to give full effect to the underlining intention of the parties. It could be said that this discretion is exercised in the realm of equity and in situations of interpretational deadlock, wherein the Court feels the need to depart from the express wordings of a contract. This could be in situations where a term is capable of having multiple interpretations and when the interpretation of such a term can substantially affect the rights of the contracting parties.

In ***Nabha Power Ltd. (NPL) v. Punjab State Power Corporation Ltd. (PSPCL) and Ors***.[14], the Hon'ble Apex Court analysed international and domestic jurisprudence on the concept of implied terms and concluded that the following conditions must be satisfied to imply terms into a contract, namely: (1) it must be reasonable and equitable to imply terms; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that "it goes without saying"; (4) it must be capable of clear expression; (5) it must not contradict any express term of the contract.

In the aforesaid case, though the Hon'ble Court implied terms into the contract it was called upon to interpret, the Court thought it appropriate to lay down a word of caution in applying the concept of implied terms, in the following words – "We may, however, in the end, extend a word of caution. It should certainly not be an endeavour of commercial courts to look to implied terms of contract. In the current day and age, making of contracts is a matter of high technical expertise with legal brains from all sides involved in the process of drafting a contract. It is even preceded by opportunities of seeking clarifications and doubts so that the parties know what they are getting into. Thus, normally a contract should be read as it reads, as per its express terms. The implied term is a concept, which is necessitated only when the Penta-test referred to aforesaid comes into play. There has to be a strict necessity for it. In the present case, we have really only read the contract in the manner it reads. We have not really read into it any 'implied term' but from the collection of clauses, come to a conclusion as to what the contract says. The formula for energy charges, to our mind, was quite clear. We have only expounded it in accordance to its natural grammatical contour, keeping in mind the nature of the contract."

Conclusion:

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[13] AIR 1962 SC 1810
[14] (2018) 11 SCC 508

The abovementioned principles are no more than guidance tools that a Judge may use while interpreting a contract. The particular facts and circumstances of the case may decide how the said principles or 'rules' of construction are applied. In practice, it is open to judges to select from these tools at their discretion in order to make the contract work, give effect to the parties' (sometimes presumed) intentions and to try to achieve reasonable justice between them. However, the fundamental principle continues to be that the express terms/words of a contract are to be given full effect to, and therefore it is imperative to be well-defined and unambiguous while drafting the commercial contract.

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