In this article, we cover the basics of contractual interpretation, address common queries and explain what you can do to protect your position.

Contractual interpretation - are there specific rules on this and how is that relevant to my business?

There are broad principles of contract interpretation (rather than strict rules) that will be applied by the court if a dispute arises as to what a contract means.

The key point is to get your contract right and clear at the outset, before you sign. Having an understanding of the basics of contractual interpretation, and why particular clauses are important, will enable you to ensure that contracts accurately reflect your intentions.

- What are the main principles of contract interpretation?
- What is an order of precedence or priority clause?
- What is a condition precedent?
- Does a mixture of standard contract terms and negotiated amendments make any difference to the interpretation of the contract?
- What is an implied term?
- Contractual interpretation - how can I protect my position?

What are the main principles of contract
interpretation?

Words will be given their natural and ordinary meaning

The starting point will be a straightforward objective reading of the actual words of the contract - what does it actually say, on the ordinary meaning of the words that have been used?

An objective approach - but with knowledge of context

In short, this means that interpretation will be based on an understanding of the contract by a reasonable hypothetical person who was aware of the relevant context of the contract and the factual background at the time the contract was entered into.

Business common sense will be applied when appropriate - to avoid an uncommercial result

Where wording is ambiguous and there is more than one possible meaning, the court is likely to adopt the interpretation that better reflects commercial or business common sense, as long as this does not conflict with the natural meaning of the words used.

The factual context and relevant background may become relevant here - as this should help the court to work out which meaning better reflects commercial common sense.

Contracts will be considered as a whole

One provision will not be considered in isolation - the whole contract and its effect in the round will be relevant.

Prior negotiations are unlikely to be considered

In most cases, negotiations prior to the finalisation of the contract will not be admissible in evidence - this includes drafts of the contract and related communications.

Whilst there are a number of reasons for this, a key reason is that prior drafts and
exchanges simply identify the terms that the parties were seeking to impose on the other, and not what was ultimately agreed.

**What is an order of precedence or priority clause?**

Commercial contracts are often complex, comprising numerous documents e.g. terms and conditions, specification, schedules etc.

An order of precedence or priority clause specifies the weight that is to be applied to the various documents forming the contract. This could be important in cases where there is an inconsistency between the documents.

As noted above, the court will seek to interpret the whole contract, and to find a consistent meaning if it can; but if it cannot, a precedence clause will determine which term prevails over the others.

When you are checking for the relevant provision of the contract at any time, it is advisable to check whether the contract contains a priority clause and the order it specifies.

**What is a condition precedent?**

This is a clause which either makes the agreement itself conditional on certain matters (as an example, a contract for the sale of land where the purchase is conditional on the vendor obtaining planning permission by a specified date) or a clause which renders the operation of certain contractual clauses conditional upon certain matters (e.g. a contractual entitlement being conditional upon the issue of a timely notification).

In order to take effect as a condition precedent, the clause must be clearly drafted.

**Does a mixture of standard contract terms and negotiated amendments make any difference to the interpretation of the contract?**

As noted above, the starting point will still be the natural and ordinary meaning of the words to an objective reader. So, if the contract can be read as a consistent whole, that is what the court will do.
In the event of any inconsistency or ambiguity, however, greater weight will likely attach to those clauses which have been individually negotiated - as opposed to standard pre-printed contract wording. This may however be subject to priority provisions, of the nature mentioned above.

**What is an implied term?**

This is a term that has not been expressly agreed/written down by the parties but is implied into the contract, either on the basis of statute or through case law.

This is a complex area, which is still developing through the decisions of the higher courts. Some of the key principles are:

- A term will only be implied if it is necessary to give business efficacy to the contract or it is so obvious that "it goes without saying" (the "officious bystander test"). A term will not be implied if it contradicts any express term in the contract.
- Whether or not a term is to be implied will be considered objectively, from the perspective of a reasonable person in the parties' position at the time the contract was finalised.
- As a result, circumstances known by both parties (but not one party only) at the time the contract was finalised will be taken into consideration.

**Contractual interpretation - how can I protect my position?**

During the pre-contract stage, make your intentions entirely clear in terms of what you are prepared to agree; and then ensure that your requirements are reflected in the contract wording.

Once the contract is finalised, remember that - in most cases - you will be held to the natural and ordinary meaning of the language that you have used. Being specific and rigorous during contract negotiations can save the wasted time and costs of a dispute about the meaning of particular clauses at a later stage.

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