Contractual Interpretation in Arbitrations: Business Efficacy and Business Common Sense

- **Gaurav Rai**[1]

An essential aspect of commercial dispute resolution is the contract between the parties. Having a well-drafted contract that covers all aspects, especially regarding the most basic of issues, is essential. The thumb rule, while drafting contracts, should be that nothing is understood or assumed, or a given. It is only when there is a lack of foresight and a situation arises not covered by one of the provisions of the contract that arbitration and dispute resolution processes begin. The author bases this on his experience of looking at contracts while analysing them during arbitration to determine the nature of rights and obligations of the parties to the contract. However, it must also be noted that arbitrations also come up when a clear meaning of an express term of the contract is onerous and secondary to the primary purpose of the contract or goes against the tenets of the statutes governing the contract. Hence, this article is an endeavour to discuss the two situations mentioned above and the principles of contractual interpretation that deal with the aforesaid scenarios.

Business Efficacy Principle

To close the gaps in the contract, the arbitral Tribunal would be guided by the principle of **Business Efficacy**. Under this principle, the Court or Tribunal implies a term in the contract that the parties would have always intended to have in the contract as prudent businessmen and by such implication, business efficacy is supplied to the contract. It is to be remembered that while applying the principle, only the bare minimum has to be implied which, helps to make the contract workable. The classic case for this principle is the opinion of Bowen L.J. in **The Moorcock (1889) 14 PD 64**, which was cited with approval in the case of ***Satya Jain v. Anis Ahmed Rushdie (2013) 8 SCC 131*** wherein the Supreme Court said that *"this test requires that a term can only be implied if it is necessary to give business efficacy to the contract to avoid such a failure of consideration that the parties cannot as reasonable businessmen have intended."*

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In ***Nabha Power v. Punjab State Power Corporation (2018) 11 SCC 508*****,** the Supreme Court outlined the jurisprudence regarding implying terms of the contract and affirmed the 5 prong (penta) test to be applied in such a scenario. The same is extracted hereunder:

> *This test has been set out in B.P. Refinery (Westernport) Proprietary Limited vs. The President Councillors and Ratepayers of the Shire of Hastings (supra) requiring the requisite conditions to be satisfied: (1) reasonable and equitable; (2) necessary to give business efficacy to the contract; (3) it goes without saying, i.e., The Officious Bystander Test; (4) capable of clear expression; and (5) must not contradict any express term of the contract. The same penta-principles find reference also in Investors Compensation Scheme Ltd. vs. West Bromwich Building Society (supra) and Attorney General of Belize and Ors. vs. Belize Telecom Ltd. and Anr. (supra). Needless to say that the application of these principles would not be to substitute this Court's own view of the presumed understanding of commercial terms by the parties if the terms are explicit in their expression. The explicit terms of a contract are always the final word with regards to the intention of the parties. The multi-clause contract inter se the parties has, thus, to be understood and interpreted in a manner that any view, on a particular clause of the contract, should not do violence to another part of the contract.*

Non-strict interpretation of express terms and Business Common Sense

On the opposite end of the spectrum of the aforesaid principle of contractual interpretation are the cases in which strict interpretation of the express terms of the contract are not followed. Many parties have an incorrect understanding that each express term of the contract, however onerous or skewed, will be followed to the letter. They forget that a well-drafted commercial contract, without any gaps, may have terms that may be inconsistent with the Indian Contract Act, 1872 or the Sale of Goods Act, 1930. Such terms of the contract cannot be enforced and the provisions of the Contract Act or the Sale of Goods Act will prevail over such terms. For example, a term in the contract expressly stating that parties will not be liable for damages for breach of the contract will fly directly in the face of Section 73 and 74 of the Indian Contract Act, 1872 and such a term cannot be enforced. This position is also supported by Section 28(1) and the amended Section 28(3) of the Arbitration and Conciliation Act, 1996. I have discussed

some of these issues in an article on exclusion clauses in a contract, which can be accessed here.

There is another principle of contractual interpretation that does not allow a strict and pedantic interpretation of the Contract. This principle of interpretation of contracts is called **Business Common Sense**. Although not in a specific context of the interpretation of commercial terms of a contract, the Supreme Court of India in ***Enercon India Limited and Ors. V. Enercon GMBH (2014) 5 SCC 1***, cited with approval the observations of Lord Diplock in ***Antaios Cia Navieara SA v. Salen Rederierna AB, the Antaios [1985] AC 191*** wherein it was stated that if a 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. This means that the strict interpretation of the contract is not preferred when enforcing such a term in the contract makes it impracticable to perform the contract. The test for business common sense being that of a reasonable commercial person. Use of the principle of business common sense is generally required in a standard contract with skewed clauses wherein there is no scope for negotiations between the parties. However, this principle, will not apply to all standard contracts but only to those terms that do not make commercial sense and/or are beyond the primary purpose of the contract. For e.g., a contract for the supply of goods may have a clause giving the buyer an option for the supply of an additional quantity of items at a later date at the same price. However, if the market conditions change drastically and the price quoted at the start of the contract may not be practical anymore for additional quantities, then in such a case fulfilling the term of the contract for additional quantities of goods would not make business common sense and the supplier may not be required to supply the additional quantities at the earlier quoted price as per the terms of the Contract.

Concluding remarks and suggestions

Interpretation of contracts is of utmost importance in arbitration matters, and any guidance regarding the principles to be used in the aforesaid scenarios was limited to foreign principles. The apprehension of an arbitral Tribunal based in India to use such principles would be understandable and hence it is immensely satisfying when an issue of interpretation of the contract in a power purchase agreement in a Thermal Power Plant was appealed all the way up to the Supreme Court and the Supreme Court recognized and relied on the principles of contractual interpretation in common law jurisdiction to provide domestic arbitrations with some affirmation in using the said principles in their awards. The Supreme Court in ***Nabha***

Power v. Punjab State Power Corporation (2018) 11 SCC 508 has outlined the literature on several principles of contractual interpretation including the ones discussed above. Although they haven't strictly implied a term in the contract using the Business Efficacy test but have stated the use of this principle and the others in the manner utilised in other jurisdictions as principles that can apply to India as well. Finally, they have also provided a word of caution and a guideline before ending with the case which is relevant for our discussion and is extracted hereunder:

> *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 terms 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.*

Hence, we see a summing up of the principles relating to both express and implied terms which, can act as a definitive guide to arbitral Tribunal when dealing with the interpretation of contracts in such a scenario.