

"Do You Know" Series



Interpretation of Contracts under Indian Law

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Produced under the project of the Asian Business Law Institute to harmonise contractual clauses in Asia

In this collection, the Asian Business Law Institute ("ABLI") briefly discusses the interpretation of a contract in select civil, common and hybrid jurisdictions. Earlier collections under the same series have examined indemnity and liquidated damages clauses as well as breach and remedy of contracts in those same jurisdictions.

The short article below provides a brief overview of some interesting points concerning the interpretation of contracts under Indian law.

General rules

As gleaned from both statute and common law in India, the general rules for interpreting the words of a contract may be summarised as follows:

- **Literal rule:** If a word used in a contract is not defined in the contract, the word should be interpreted in its plain, ordinary and literal meaning. A contract must be read as per its express terms, unless there is a strict necessity to use implied terms.
- **Golden rule:** A shift from the literal rule is allowed when the overall content of the document demands or when the literal rule creates absurdity.
- **Purposive interpretation:** To make such an interpretation, the intention of the parties should be clearly understood from the language of the contract, and this should be considered in light of the context and object of the contract.

There is thus scope for both literal and purposive interpretation under Indian law. On the other hand, Indian law largely leans towards an objective stance of interpretation. While it is essential to consider subjective evidence to understand the true meaning of a clause in a contract, the subjective theory of presumed intention of parties is used by the court as a shield to prevent the contract from being interpreted in a way contrary to such intention of the parties.

In addition, it is not uncommon for Indian courts to take into account the drafter of the contract to accord the benefit of doubt in favour of the non-drafting party in the event of multiple plausible interpretations. For this reason, many commercial contracts in India contain explicit provisions to the effect that no regard should be had to which party drafted the contract or a particular clause therein.

Interpreting specific clauses, words and concepts

Certain clauses are subject to special rules of interpretation under Indian law. For example, the judiciary has repeatedly noted that when interpreting a liquidated damages clause, it must be assured that the quantum of the damages defined in the contract is reasonable. An exclusion of liability clause must be drafted with a cautious mindset and must be clear, specific and unambiguous. When such a clause is unclear, courts will invoke interpretative mechanisms to read reasonability into the clause. This is done in two ways. The first is to interpret the clause in favour of the party who has not drafted the contract, and the second is to read the clause in light of the object of the contract and the intention of the parties. It is, however, possible to exclude the

operation of such interpretative mechanisms. As mentioned above, parties may explicitly state that no regard should be given to who "held the pen" for a particular clause. Clauses may also contain explicit statements as to the intention of the parties (i.e., beginning with "*It is the intention of the Parties that...*") to prevent misinterpretation at a later stage.

The doctrine of good faith is not expressly provided for in the Indian Contract Act, 1872 ("ICA"), despite certain provisions in the ICA that impose obligations on employers to indemnify agents for acts done in good faith. However, "good faith" has largely found its way into Indian law and contracts as a common law concept, and is largely incorporated into most contracts, either expressly or by implication. The operation of "good faith" can happen at different points in time, depending on the nature of the contract. For example, in an insurance contract, utmost good faith (*uberrimae fidae*) is necessary when the parties enter into the contract. In an employment or agency contract, "good faith" seeps in during the performance of the contract where, as mentioned earlier, the employer must indemnify a third party for any losses caused by the acts of its agent, if such acts were conducted in good faith.

Indian law provides the possibility to exclude the "good faith" obligation in contracts. Parties can choose to incorporate in their contract a clause that explicitly removes the requirement of good faith. However, as held by the Supreme Court, courts may refuse to enforce such an exclusion clause if it is found to be unconscionable.

Indian law has the concepts of "reasonable efforts" and/or "best efforts". "Best efforts" usually refer to the best standard of efforts that a party needs to make, and the party must try all possible means to fulfil its obligations. "Reasonable efforts" hold a party to a lower standard and require it to make as much effort as a reasonable person would when trying to fulfil its obligations. Terms such as "commercially reasonable efforts" have also evolved, which cast upon a party an even lower standard than "reasonable efforts". However, such distinction is often academic, and the terms are often used interchangeably in practice.

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The experts are contributors to ABLI's latest project that aims at harmonising contractual clauses in Asia, covering 12 key contracting jurisdictions that include Australia, China, England, India, Indonesia, Japan, Malaysia, New York State, the Philippines, Singapore, Thailand and Vietnam.

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