Do not fall into the Pitfall of Poor Contract Drafting

We are seeing an increase in disputes arising out of poorly drafted contract provisions that offer multiple interpretations, leaving those tasked with applying and/or interpreting such provisions guessing as to what the parties originally intended.

By its nature, contract drafting always entails some risk of error, particularly where commercial teams are under pressure to close transactions quickly, at times without input from legal counsel. Most of us will have experienced some of the issues this gives rise to particularly where boilerplate clauses are copy pasted from one contract to another assuming that because something worked in the past it should work in the current contract, without regard to the actual deal or other contract terms. Given the increase in international arbitrations where we are advising on claims arising from imprecise contract drafting, we thought it timely to remind contacts in the industry how costly simple drafting mistakes can be and the issues faced in overcoming them.

Mind your punctuation

In 2006, Canada's largest cable television provider, Roger Communications of Toronto, lost CAD 1 million in a court case with telephone company, Bell Alliant, because of a misplaced comma in a contract. The contract provided that it “shall continue in force for a period of five years from the date it is made, and thereafter for successive five year terms, unless and until terminated by one year prior notice in writing by either party.”

The cable television company believed and intended that the contract was secure for the first five years and entered into the contract on this basis. However, the second comma after “terms,” altered the meaning as it allowed the telephone company to terminate the contract at any time on giving one year’s notice.

This mistake is not necessarily obvious at first sight but any vigilant lawyer reading and reviewing the contract should have realised that the contract can be terminated at any time upon the requisite notice being given. This one comma cost significant loss, which was easily avoidable by careful reading and drafting.

“Back to back” really?

One issue we frequently encounter is the issue of whether a subcontract is actually back-to-back, such that entitlement to payment (and other relief or entitlement) is subject to the contractor first receiving such payment or relief from the employer. This is a common type of clause in the Middle East, and is used mainly to protect the main contractor's solvency where there is delayed payment from the employer.

A typical back-to-back clause in subcontracts prepared by commercial managers, which we see time and time again states, “This subcontract shall operate on a “back-to-back” basis to the main contract.”

On a first reading, and to a non-lawyer, this clause is simple and clear. It simply states the subcontract is back-to-back with the main contract. However, this clause in itself is usually not sufficient to have this effect and on closer examination the subcontract will contain clauses bearing little similarity to the payment obligations under the main contract, will not limit entitlement in respect of delay and additional payment to circumstances where the contractor receives such relief from the employer in the first instance.

Often the main contract is not even defined and the main contract clauses are not included or referenced.
Consequently, such a subcontract does not give effect to the main contractor’s intention that it is to be back-to-back. If these issues are not resolved at the drafting stage, the main contractor may find itself in an unfortunate situation where the subcontractor is entitled to payment whether or not the main contractor receives payment under the main contract, or where the subcontractor may be entitled to an extension of time under the subcontract where the main contractor is yet to receive the same relief under the main contract.

Rules of interpretation and the contra proferentem rule- a dying friend?

In interpreting clauses whose terms are disputed, it is our experience that arbitrators generally take a practical approach and examine the dispute from a commercial viewpoint. How a clause will be interpreted, will, of course, depend on the law of the contract.

As a general rule, common law and civil law jurisdictions apply different tests for interpreting contracts. Common law jurisdictions will apply an objective test and the question that will be applied is what a reasonable person having all the background knowledge available to the parties understood the language in the contract to mean. In comparison, civil law countries apply a subjective test to determine what the real intention of the particular parties to the contract was.

Under common law, parties sometimes also seek to rely on the contra proferentem rule in interpreting ambiguous contract terms, which interprets the clause against the party who put it forward. While this principle can be helpful, it is not the starting point in interpreting contracts in common law jurisdictions. Courts will frequently emphasise that the natural meaning of the words used by the parties and the contract is to be construed as a whole in light of the surrounding facts including the commercial implications of each interpretation. The contra proferentum principle only applies where the wording in question still remains ambiguous.

In England and Wales, courts are increasingly recognising that parties to commercial contracts should be free to allocate risks as they see fit. In Persimmon Homes v Ove Arup [2017] EWCA Civ 373 the Court of Appeal declined to apply the contra proferentum rule to an exclusion clause in a significant commercial contract because it considered that the contra proferentum rule now had a limited role in relation to commercial contracts negotiated between parties of equal bargaining strength.

It is worth noting that we have seen an increase in contracts that expressly exclude the application of the contra proferentem rule. If you intend for this rule to apply (in the knowledge of the limitations noted above), you must carefully review your contract to ensure it is not expressly excluded.

Civil law jurisdictions often will have rules similar but not identical. By way of example, Article 266 of the UAE Civil Code provides that “doubt is construed in favour of the debtor.” This is a difficult provision to interpret in itself and it is not clear if it seeks to achieve the same principle as the contra proferentem rule.

Concluding thoughts

As an international practice instructed on disputes across the globe we are increasingly seeing more disputes arising as contract terms are not certain.

Often disputes, which emerge, could have been avoided with careful drafting. Those too close to a project risk drafting what they mean by using wording which is imprecise, and which does not have the meaning intended.

Having an independent third party review or carry out the drafting could help negate this risk. At the end of the day, however, there is no substitute for a well thought out and properly drafted contract.

For further information please contact:

Antony Smith
Partner
+44 (0) 20 7469 0406
a.smith@beale-law.com

Sadaff Habib
Associate
+971 (0) 4 356 3902
s.habib@beale-law.com