Contract Interpretation: Guidelines and Best Practices

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The process of determining the original intent of the contractor and owner is referred to as **contract interpretation**. This procedure typically involves establishing definitions, adding omitted words, and clarifying confusing or contradictory phrases.

Contract performance disputes are often the result of simple misunderstandings. Therefore, it is important for all parties- contract owners, prime contractors, and subcontractors- to understand the guidelines courts typically use to interpret contracts. Carefully drafting contracts according to some well-defined best practices is just as important; clear and explicit wording is the best defense against misinterpretations.

Courts and boards of contract appeals typically focus on two sources of information to establish intent: the contract language and extrinsic information.

Courts interpret contracts by using the "objective test." This means that the court's interpretation of a contract must be "consistent with a reasonably intelligent person familiar with all of the facts and circumstances surrounding contract formation." To help reach their conclusions, courts take several factors into consideration.

First, the contract must be read as a whole. The agreement between two or more parties is defined by the document as a whole, not by a single word, phrase, or clause. Therefore, disputed terms are to be considered within the context of the document as a whole. The best interpretation is the one that "gives effect to all terms and leaves no clause meaningless."

Second, key contract terms must be clearly defined. In the best-case scenario, terms are clearly defined within the contract, leaving no room for misinterpretation. In government contracts, key terms are often referenced in the *Federal Acquisition Regulation* 2.1. If a key term is **not** defined in the contract or referenced by FAR, courts next use dictionaries and common usage to determine the proper definition. Finally, if the context suggests that the word or phrase in question was a technical term and not a common usage, then the appropriate technical term

will be used as the definition. It's important to realize that key terms can, and often do, appear throughout the contract in several different sections.

The Order of Precedence Clause assists courts when one section contradicts another- not uncommon with lengthy, complicated contracts. The Order of Precedence described in **FAR** 52.214-29 and 52.215-8 dictates that precedence is given in the following order:

1. The schedule
2. Representations and other instructions
3. Contract clauses
4. Other documents, exhibits and attachments
5. The specifications

Individual agencies may also have their own supplementary Order of Precedence clauses.

Extrinsic evidence is another powerful tool used to interpret contracts. Documentation of phone calls and meetings, emails, quotes and proposals can help a court determine both parties' intent at the beginning of the contract. In addition, the parties' conduct after the contract's award, but before the dispute, can help the court discern the original interpretation of the disputed term.

Prior dealings can also be used to establish intent of the involved parties; past actions set a precedent for future interactions.

Related documents, such as bids, quotes, and proposals, can put certain phrases in context and help the court better define contract terms.

Although this information can help clarify vague items, extrinsic evidence does not supersede the contract itself. The Parol Evidence Rule "states that only what is written in the contract really matters and all previous verbal and/or written statements are null and void."

When a contract term is hopelessly ambiguous, *Restatement (Second) of Contracts*, Section 206, dictates that the writer of the contract loses any arguments of interpretation. However, interpretation against the drafter (*contra proferentem in Latin*) will **not** be applied if the non-drafting party fails to seek clarification on an uncertain term for which it was (or should have been) aware.

Clearly, with so many variables, it's better to draft an explicit, clear-cut contract than to rely on a court's interpretation of a poorly written one. By implementing best practices, contractors

can shield themselves from poorly written, misleading, contradictory, or confusing contracts and the potential problems that go along with them.

A common-sense approach to contract drafting involves three critical elements:

Clearly defined key words and terms

Key words and terms can be defined within the contract itself; in a contract glossary or dictionary of terms; or can be referenced within specific publications, such as the FAR, related agency supplements, technical dictionaries, industry standards, etc.

Tailor the terms and Conditions to the contract Situation

Many contracts, especially government contracts, contain so many clauses that the average contractor does not read (or understand) them all. Contracts should be tailored to fit a specific job; consideration should be given to the nature of the services and/or products provided, the complexity of the project, and the urgency of each requirement.

Read and understand all contract terms

Unfortunately, skimming over contract details or relying on the other party's summary of a contract's contents is not uncommon. A thorough knowledge of all contract details is critical to avoiding disputes. This is not an area to cut corners.

For more information, see "Contract Administration, Part 3: Contract Administration Guidelines and Best Practices" by Gregory Garrett, Contract Management, April 2010.

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