

What are Side Letters in Transaction Documentation

Concept¹

A Side Letter is a document that is ancillary to a contract, which may either clarify or supplement or vary the contract. A Side Letter much like a MoU or any other agreement, is capable of being treated as a contract by itself, which is capable of giving rise to rights and liabilities qua the parties to such Side Letter, which are binding and enforceable. The Side Letter and the Agreement must be read together for complete and proper construction of the contractual relationship between the parties to the contract in respect of their specific agreement.

Any First Party may enter into the Agreement with the Other Party and thereafter issue the Side Letter upon Other Party for setting up, running and operating specific items permissible in law. Both the Agreement and the Side Letter will give rise to legally enforceable rights and obligations. The Agreement and the Side Letter can be specifically enforced under the Specific Relief Act, 1963.

To satisfy the condition that the side letter is an enforceable agreement it must satisfy the following broad conditions:

- a. That there is a clear intention to create legal relations.
- b. That it is not an agreement to agree into an agreement.
- c. That the terms are clear and unambiguous.
- d. That the subject matter is certain.
- e. That there must be flow of consideration.

Judicial Precedents

In the case of *Barbudev v Eurocom Cable Management Bulgaria EOOD and others*² the court observed that the side letter was a mere 'agreement to agree', and was hence unenforceable in English law. Since the side letter was unenforceable, the was concluded that the letter was not intended to create any legal relation between the parties.

This case was further followed in *Dhanani v Crasnianski*³ where the Court had observed, "the circumstance that an agreement is no more than [an] agreement to negotiate and agree may show objectively that the parties to it cannot objectively have intended it to be legally binding, notwithstanding that it had certain characteristics which otherwise might have evinced an intention to agree". Therefore, the Court of Appeal ultimately agreed with the High Court that the side letter in question here was unenforceable, since it was no more than an 'agreement to agree'. However, what is significant is that the Court of Appeal divorced this question of enforceability from the independent question of whether the side letter was intended to create legal relations.

This decision was a useful clarification of the two step process involved in determining the binding nature of an agreement between parties: focussing, first on the intention of the parties (as objectively evidenced by the terms of the agreement and

¹¹Article on 'Validity and legal enforce-ability of side letters in India' available at <http://advocatechenoyceil.com/tag/side-letter/>

²[2011] EWHC 1560

³[2011] EWHC 926 (Comm)

the communication between them), and only later on the second question of whether this intention to create legal relations had been successfully implemented through an enforceable contract.

In the case of **Companies Act vs Global Earth Properties** (APPEAL No. 139 OF 2008) where the plaintiff sought to rely on the extension clause in the side letter to leave and license agreement the court observed that *“The letter itself makes a reference that we have already executed today the leave and licence agreement, the amenities agreement and the agreement for security deposit, collectively the agreements, and thereafter the said letter has been written. Therefore, whether the said letter is to be treated as executed simultaneously with the other three agreements or it is a subsequently written agreement is a matter to be scrutinized in the evidence. If it is found that this letter is binding as against the Defendant No. 1, then the specific performance of this letter can be enforced as against the Defendant No. 1. But for whatsoever reason in final analysis after evidence if the Court finds that this letter is not binding as against the Defendant No. 1, the specific performance of the agreement cannot be granted. This depends upon the binding nature of the clauses from the leave and license agreement referred to above.”* But eventually the letter was held to be not binding.

Importance⁴

- Side letters are useful when parties wish to complete the transaction without finalizing the terms of certain aspects of the deal, the broad contours of which may be included in a side letter for formalization post-closing.
- They are used to set out private inter-se arrangements between some (but not all) of the parties to the principal documentation.
- A Side Letter is a document that is ancillary to a contract, which may either clarify or supplement or vary the contract.
- Providing clarification, such as when details become available which were not known when the contract was originally entered into.
- Supplementing negotiations between parties by providing additional obligations or exemptions.
- Confirming variations where last minute changes have been made, where it is not practical or cost-effective to re-draft a substantial document.

The Barbudev case (supra) serves as a useful reminder of the willingness of courts to find an intention to create legal relations, especially between parties dealing in a business context. Particularly where documents are prepared by lawyers (or other parties with professional knowledge), the court will be easily persuaded that the necessary intention existed. Where parties do not wish to find themselves bound, this should be explicitly stated in the document. Conversely, where parties do wish a side letter (or similar document) to be an enforceable contract, they must ensure that it is sufficiently clear and complete; it is a false economy to use a side letter as a substitute for a fully negotiated agreement.⁵

⁴ Article on ‘Enforceability of Side Letters’ available at <http://indiacorplaw.blogspot.in/2011/07/enforceability-of-side-letters.html>

⁵ Article on “Are Side Letters legally binding?” available at <http://www.farrer.co.uk/Global/Briefings/02.%20Corporate%20briefings/Are%20side%20letters%20legally%20binding.pdf>