Fenwick Elliott
The construction & energy law specialists

Issue 16, October 2012

Welcome to the October edition of ***Insight***, Fenwick Elliott's newsletter which provides practical information on topical issues affecting the building, engineering and energy sectors.

In this issue find out about side letters and how to write them.

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Agreement to Agree or Agreement?

Side letters are often used by parties (i) in place of formal contracts, (ii) to provide assurance in relation to future contracts and (iii) to document any last-minute changes to contracts. The difficulty is that they are not always written in such a way as to be legally binding.

This sixteenth issue of Insight considers the decision of the Court of Appeal in Barbudev v Eurocom Cable Management Bulgaria EOOD & Ors [2012] EWCA Civ 548, and provides practical advice on what to do if (i) you want a binding side letter, (ii) you do not want a binding side letter and (iii) how to proceed if you want only part of your side letter to be binding.

Side letters are the equivalent of letters of intent which are commonly used in the construction industry. The legal principles referred to in this issue of Insight therefore apply equally to letters of intent and side letters.

The Barbudev case

The facts

Barbudev concerned a side letter to a Share and Purchase Agreement (an agreement through which companies are commonly sold) in relation to the proposed sale of a Bulgarian cable TV and internet company which appeared to offer Mr Barbudev (the investor) the opportunity to invest in a newly merged entity on terms that were to be agreed in an Investment and Shareholders Agreement.

The side letter confirmed that Eurocom Cable Management Bulgaria EOOD & Ors (the sellers of the company) would negotiate the sale of the company in good faith and some of the principal terms of the investment (including a minimum sale figure for the company of not less than €1.65million) were included. The side letter was drafted by lawyers, contained legal terminology such as "in consideration of your agreeing to enter into" and ended with an English law jurisdiction clause.

Ultimately, the Investment and Shareholders Agreement was never entered into and Mr Barbudev sought to enforce the terms of the side letter in relation to the lost investment opportunity he said he suffered when his investment fell through.

The case went first to the High Court and then the Court of Appeal.

Decision of the High Court

The High Court emphasised that whilst it was clear the parties intended the side letter to be a binding contract, a mere intention to create legal relations was not enough. The obligations the parties intended to create must also be enforceable.

The side letter did contain some information about the proposed terms of the investment but not in sufficient detail to be legally enforceable. The key terms of the agreement had not been fixed and the sale price of "not less than" €1.65m was too uncertain.

Decision of the Court of Appeal

The Court of Appeal disagreed with the High Court that the parties had intended the side letter to be legally binding, but agreed that the terms of the side letter were too vague to be enforceable. The outcome was therefore the same in the High Court as in the Court of Appeal.

The side letter did no more than provide Mr Barbudev with "*the opportunity to invest in the Purchase on terms to be agreed between us*", which was not the language of a binding commitment, regardless of the commercial context and purpose for which the side letter was produced.

What Mr Barbudev was left with, therefore, was an "agreement to agree".

How do you make sure a side letter is legally binding?

For side letters to have legal force, they must meet the requirements of a contract under English law. The parties must demonstrate (i) a clear and unambiguous intention to enter into a contract and (ii) an agreement as to the key terms (such as price) or an objective means for achieving agreement of those terms.

It is not sufficient to ask your lawyer to draft your side letter as this will not of itself create a legally binding contract. What you need to do is to think more about the substance (or content) of the side letter.

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A legally binding side letter should:

- Contain terms that imply certainty (use words such as "shall");
- Contain language that demonstrates that the key terms are already agreed, as opposed to being open for further negotiation by one of the parties;
- Include payment terms;
- Not be open to change by one of the parties;
- Cover all the key issues, not just some of them;
- Confirm the parties intend the document to be legally binding;
- Be signed by both parties once agreed; and
- If you are incorporating terms by reference, be very clear which standard form of contract, or draft contract, and which terms of that contract you mean to incorporate.

If the above cannot be done and you want your side letter to be legally binding, then it is best not to use a side letter at all.

What should you do if you do not wish your side letter to be legally binding?

This sounds unusual but not as unusual as you might think, since parties often use documents to record their legal intentions without wishing to be legally bound. Heads of terms of agreement are a good example.

If you do not want your side letter to be legally binding, extra care must be taken to rebut the automatic assumption that the parties intended to create legal relations.

Your side letter should:

- Be headed with the words "subject to contract" so it is clear that the parties are still negotiating and finalising terms;
- Contain phrases such as "terms to be agreed" or "terms to be negotiated";
- Reflect the fact that there are matters that are still to be agreed (for example, identify the contract that needs to be prepared);
- Be as vague as possible. State that the terms are not exhaustive and use phrases such as "may agree" and "may negotiate";
- Explicitly state that the parties do not intend to be contractually bound by the side letter.

If you want some of the terms to be legally binding

If possible, you should try and avoid only some of the terms being legally binding as the side letter will then contain grey areas and it will be easier for it to be challenged at a later date.

If you have no alternative, clearly specify which provisions are intended to be legally binding and which are not. Generally, clauses which contain confidentiality and other commercial boilerplate clauses, such as law and jurisdiction clauses, will be binding.

Conclusion

If a side letter (or letter of intent) is to be binding, it must function as a free-standing contract and comply with the ordinary principles of contract law.

A free-standing contract has two essential ingredients.

First, in the context of commercial contracts such as side letters or letters of intent, there must be an intention to create legal relations. This intention is automatically presumed but it can be rebutted if one of the parties wishes to contest any presumed intention. In order to determine the intention of the parties, the court will look at the objective conduct of the parties and the surrounding facts.

Secondly, the alleged agreement must make sense commercially and its terms must be sufficiently clear so as to be capable of enforcement. If this is not the case, then the parties' intention for the agreement to be enforceable will be irrelevant.

In summary, lack of certainty is fatal to the existence of an enforceable contract and the reason for this is obvious: courts cannot enforce vague terms because (i) they cannot decipher what vague terms might mean in a commercial context and (ii) it would deprive the parties of their right to contract upon such terms as they consider fit.

Should you wish to receive further information in relation to this briefing note or the source material referred to, then please contact Lisa Kingston.
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