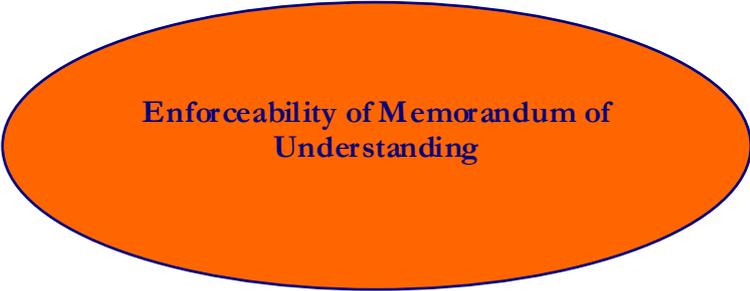


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Enforceability of Memorandum of Understanding

INTRODUCTION

A Memorandum of Understanding (“MOU”) is the term given to a formal agreement between two or more parties expressing their determination to move forth in a common direction. Usually at the outset of a project or joint venture, the parties record their intention to work together and the basic terms under which they capture their intent to pool their resources or work together. This is often a basic and preliminary agreement which lays the foundation for subsequent and specific contracts and is referred to as a MOU, or letter of intent.

The concept of MOU has emerged due to complicated and often lengthy oral business negotiations and the need to put down the residue of such extensive negotiations on paper, not only for record, but to prevent deviation from the plan of action so devised after negotiations. The term “*Memorandum of Understanding*” has been defined in Black’s Law Dictionary as a non-committal written statement detailing the preliminary understanding of the parties who plan to enter into a contract. The MOU may be meant just to record the consensus of the parties and may not be intended to raise an obligation or, in some cases, may create an obligation on either party.

This newsletter focuses on the position of MOUs vis-à-vis enforceability under Indian Courts and the judicial trend in this regard to equip the reader with the consequence and standing of MOUs in India. The principal statute governing contractual relations and a few relevant judicial pronouncements been briefly discussed to allow the reader a better understanding of the enforcement of a MOU in India.

1. Legal position under Indian Law

1.1 The Indian Contract Act, 1872 (“the Act”)

The Act is the principal legislation governing contractual obligations and contracts in general. An agreement, as defined under the Act, is a promise or a set of promises forming the consideration for each other. Interestingly, a contract is defined as an agreement which is enforceable by law¹. Further, the Act has a provision which clearly provides for agreements which are contracts. Section 10 clarifies substantively the position of the Indian law with regard to contracts. It provides that agreements made by parties, competent to contract under the Act, of their own free will and for a lawful consideration and object are contracts and, thus, enforceable². MOU does not find a definition under the Act, and thus can fall under the definition of an agreement, or that of a contract.

On a *prima facie* analysis, the fundamental characteristic of a contract is the intention of the parties to enter into a binding agreement or obligation, which results in the formation of a contract. Further, clauses under the MOU making provision for an enforcement mechanism in case of breach by either party will confirm that the parties did intend to enter into a binding agreement.

1.2 Judicial pronouncements

¹ Section 2 (h), The Indian Contract Act, 1872.

² Section 10, The Indian Contract Act, 1872.

The fundamental concern that arises is that when the MOU is not implemented and the party aggrieved wants to enforce some of its provisions. There has been ample litigation which has provided an insight into the judicial reasons for enforcement of MOUs. Essentially for enforcement of a MOU, the focus of the courts is on the intention of the parties as reflected under the document and not the form or title of the document. Some of the precedents are discussed below.

In *P. Panneerselvan v. A. Baylis (Deceased through legal representatives) and Others*³, the Madras High Court settled a case where the appellant and respondent had entered into an agreement for the sale of land. The agreement simply contained a clause recording the fact that the respondent is willing to sell land for a particular amount. The agreement made no reference to the time period within which the land would be sold or any reference to the description of the land which was to be sold. It did not even refer to the rate at which the consideration was calculated or the area of the land to be sold. The Court observed that on the face of the so-called agreement, the relevant factors as enumerated above were absent, which necessarily gave rise to an element of doubt as to the intention of the parties to the so-called agreement. The said agreement was vague and also was bereft of material particulars and it was not considered a concluded agreement, therefore unenforceable.

On the other hand, in *M/S. Nanak Builders and Investors Pvt. Ltd. v Vinod Kumar Alag*⁴ the Delhi High Court held that where the essential substantial terms have been agreed upon and reduced into writing, and the agreement so entered into does not mention that another formal agreement will be executed, the Court would not consider the agreement an incomplete agreement. In this case, the plaintiff and defendant entered into an agreement to sell wherein the defendant agreed to sell immovable property and deliver possession to the plaintiff. Subsequently, the defendant refused to accept the consideration paid by the plaintiff stating that no contract is in force and the document signed earlier was merely a receipt. The court held the agreement to be a contract and further provided that the mere

heading or title of a document cannot deprive the document of its real nature. Law is well settled in such matters that it is the substance which has to be seen and not the form.

The courts do not expect commercial documents to be drafted with strict precision. However, as described above, for an MOU to be legally binding, the essential terms must be sufficiently clear and certain.

Further in *Chairman cum Managing Director, Tamil Nadu Tea Plantation Corporation Ltd. v. Srinivasa Timbers*⁵, the respondent had submitted a bid for the tender invited by the petitioner which had been accepted. Pursuant to the acceptance of the bid, the security amount had been furnished by the respondent; however, no formal agreement was executed between the two. The Court, deciding on the acceptance of the bid did not consider it to be an executed contract since the invitation to bid provided for a substantive contract to be entered into by the parties on the bid application being successful, and, accordingly, held it unenforceable.

Therefore, where the MOU stipulates a subsequent contract, and the subsequent contract forms the primary basis of the relationship between the parties, the MOU cannot be made obligatory on either party.

2. Survival clauses under MOUs

Often, MOUs have clauses which remain binding upon the parties regardless whether the entire MOU is binding or not. For example, most MOUs provide (or must provide) that any confidential data shared during the term of the MOU and for a certain period thereafter will continue to remain confidential. Post-execution of an MOU, there is a phase when parties work together and share each other's confidential information and data in an endeavor to progress towards the next phase of the business relationship i.e. towards execution of definitive agreements. In some cases, the parties may be unsuccessful in making the transition to execution of further envisaged agreements. Where the MOU does not

³ 2006 AIR (Mad) 242.

⁴ 1991 AIR (Del) 315, 1991 RLR 87, 1991 ILR (Del) 303.

⁵ *Chairman cum Managing Director, Tamil Nadu Tea Plantation Corporation Ltd. v. Srinivasa Timbers*, AIR 1999 Mad 111, *Dbulipudi Namayya v. Union of India*, AIR 1958 AP 533.

evolve into the contemplated contract(s), and one party breaches the confidential information, then the non-defaulting party will have a cause of action against the defaulting party, even where the balance of the MOU may be ambiguous of its binding character.

There is no fixed rule providing for the enforcement of such clauses since cases are decided on the basis of particular facts and circumstances. However, gauging the prevalent judicial trend, if the parties specifically agree for a particular clause to be binding, it can be enforced. Where the parties specifically provide for the survival or continuance or a specific obligation, the MOU can be enforced; however, only to the extent of the obligation specifically provided for.

3. Enforcement of MOU

3.1 Enforcement under the Specific Relief Act, 1963

For enforcement of a MOU in India, the primary focus of the Courts is on the intention of the parties to enter into a legally binding relationship. As evident from various judicial pronouncements discussed in section 1.2 above, if the MOU clearly indicated the intention of the parties to form a legally binding relationship, it is equivalent to a contract as defined under the Act.

Where the MOU satisfies the criteria for a contract under the Act, the performance can be enforced under the Specific Relief Act, 1963 (“SRA”). The enforcement under the SRA is by way of specific performance of whole or part of the MOU. Under Section 10 of the SRA, specific relief will only be granted where the extent of damage due to non-performance cannot be ascertained, or where compensation in monetary terms cannot provide sufficient relief to the aggrieved party.

By a petition for specific performance, the Court may direct the party in default to either perform the whole or part of the contractual obligation. The Court has discretion on the subject of granting specific performance, and despite fulfillment of the conditions mentioned under Section 10, it is

not mandatory for the Court to grant the application for specific relief.

Usually the obligations conferred under a MOU are in the nature of execution of a contract in the future, or to collaborate in a business venture prospectively. The opportunity lost due to non-compliance can, obviously, not be compensated in monetary terms. In any case, it is the prerogative of the party aggrieved to apply for specific performance, and the discretion of the Courts to grant such an application⁶.

3.2 Promissory estoppel

In certain cases the Courts may not hold the MOU to be a contract. In such cases, the doctrine of promissory estoppel may come to the rescue of the aggrieved party since a petition for enforcement under promissory estoppel does not require a pre-existing contractual relationship.

The principle of promissory estoppel was explained in *Century Spinning and Manufacturing Co. Ltd. v. Ulhasnagar Municipal Council* by the Court as follows, “A representation that something will be done in the future may result in a contract if another person to whom it is addressed acts upon it... If the representation is acted upon by another person, it may, unless the statute governing the person making the representation provides otherwise, result in an agreement enforceable at law...”⁸

The principle of promissory estoppel was settled by the Supreme Court of India in its landmark decision in *Motilal Padampat Sugar Mills Co. Ltd. v. State of Uttar Pradesh* wherein it opined that the doctrine of promissory estoppel is a principle evolved by equity to avoid injustice where a promise is made by a person knowing that it would be acted upon by the person to whom it is made, and in fact it is so acted upon, and it is inequitable to allow the party making the promise to go back upon it.

⁶ *Sen Mukherjee & Co. v. Chhaya Banarjee*, AIR 1998 Cal 252, See also *Prakash Chandra v. Angadlal*, AIR 1979 SC 1241, (1979) 4 SCC 393.

⁷ [1970] 3 SCR 854, AIR 1971 SC 1021, (1970) 1 SCC 582.

⁸ *Ibid*.

⁹ [1979] 2 SCR 641, AIR 1979 SC 621, (1979) 2 SCC 409. Also see *Union of India v. Godfrey Phillips India Limited*, AIR 1986 SC 806; (1985) 4 SCC 369.

The applicability of the doctrine of promissory estoppel does not require a pre-existing or a contractual relationship, as mentioned above. This position has been settled in *Motilal's case* wherein the Government of Uttar Pradesh had declared that all new industrial units would be exempted from sales tax. Taking into consideration this representation by the government, the petitioner had set up an industrial unit in the state; however, once it started manufacture, the government refused exemption. The respondent primarily based its arguments on the fact that there was no contractual relationship between the petitioner and the respondent. The petitioner relied upon the doctrine of promissory estoppel, and the Court settled the legal proposition as follows, “*the doctrine of promissory estoppel is a principle evolved by equity to avoid injustice and though named ‘promissory estoppel’, it is neither in the realm of contract nor in the realm of estoppel, but is a doctrine evolved by equity in order to prevent injustice where promise is made by a person knowing that it would be acted upon and in fact it is so acted upon it is inequitable to allow the party making the promise to go back upon it*”.

It would be useful to refer to the pronouncement of the Delhi High Court in *Welman Hindustan Ltd. v. NCR Corporation*¹⁰. In this case, the Court consider a letter of termination issued by a foreign partner in a joint venture company wherein a contention has been raised by the defendants that the agreement was not complete because further agreements had been required to be executed. The Court held that the plaintiff had a good case in as much as they were able to show that the parties have acted upon the terms of the letter of intent and that the plaintiff had expended considerable sums of money relying on such terms under the letter.

Therefore, promissory estoppel is relevant for the enforcement of a MOU where one party has acted on the basis of what was agreed to under the MOU. In India, promissory estoppel is allowed as a cause of action for invoking the Courts intervention for enforcement and the same was settled in *Motilal's case* discussed above.

CONCLUSION

The enforceability of the MOU depends upon the intention and negotiations between the parties as reflected in the terms of the MOU. Practically, making the MOU enforceable by clearly stating so or including a term/clause under the MOU will make it enforceable and add a shade of certainty to the negotiations. It is important for the parties to decide whether they wish to be bound by the terms of the MOU. This is a decision which will change from project to project and will depend upon the nature of transaction.

It is also common practice for an MOU to be part binding and part non-binding. This form of MOU clearly outlines the obligations and responsibilities. The enforcement of the part of the MOU which is binding will remain same as explained above.

Whether an MOU is binding or not is a question which is subject to adjudication by the courts. As noted above, the MOU will be binding if there is offer, acceptance, intention to be legally bound and consideration or where a party has acted upon an MOU. At the cost of repetition, the intention of the parties at the time of signing the MOU is of primary significance while deciding its enforceability

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¹⁰ 1992 (4) DLT 683, 1993 AIR (Del) 32. Also see *Modi Rubber Limited v. Guardian International Corporation*, 2007 (141) DLT 822.



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