

## Private Equity Corner

April 27, 2022

### DISPUTES IN PRIVATE EQUITY: INTERPRETING THE MISCELLANEOUS

Every agreement typically consists of a cluster of clauses towards the end, generally termed as 'miscellaneous' clauses and otherwise known as 'boilerplate clauses'. Since the boilerplate clauses are perceived as non-substantive and distinct from other transaction specific sections that are considered the core of an agreement, these clauses are often included in contracts without any concern for the consequences and are unfortunately typically ignored. The boilerplate clauses acquire significance when a dispute arises regarding the terms or interpretation of the contract. A mistake in drafting these clauses could impact the outcome of the dispute. Therefore, it is critical to understand the role and impact of these clauses. In this article, we will address the issues concerning and the developments surrounding three boilerplate clauses that we regularly encounter, i.e., *Entire Agreement*, *Severability* and *No Waiver*.

#### ENTIRE AGREEMENT

It is a general principle in common law that an unambiguous written contract cannot be qualified, supplemented, or varied by oral or extrinsic evidence. This principle, also known as the 'Parol Evidence Rule', is captured under Section 92 of the Indian Evidence Act, 1872 ("**Evidence Act**"), which provides that *no evidence of any oral agreement or statement shall be admitted, as between the parties to any instrument, for the purpose of contradicting, varying, adding to, or subtracting from, its terms*. This rule is, however, subject to certain exceptions. For example, oral evidence may be admitted to establish a collateral oral agreement as to any matter on which the document is silent and not inconsistent with the written terms.

An *entire agreement* clause has a similar purpose as the Parol Evidence Rule but has a broader effect.<sup>1</sup> While the exact scope of an entire agreement clause depends on its precise wording, it usually provides that the written agreement is the complete agreement and shall supersede all prior agreements and understandings, both written and oral, among the Parties with respect to the subject matter of the agreement. In *Inntrepreneur Pub Co v East Crown Ltd.*<sup>2</sup>, the court explained the purpose of an entire agreement clause as follows:

*The purpose of an entire agreement clause is to preclude a party to a written agreement from threshing through the undergrowth, and finding in the course of negotiations some (chance) remark or statement (often long forgotten or difficult to recall or explain) on which to found a claim such as the present to the existence of a collateral warranty. The entire agreement clause obviates the occasion for any such search and the peril to the contracting parties posed by the need which may arise in its absence to conduct such a search. For such a clause constitutes a binding agreement between the parties that the full contractual terms are to be found in the document containing the clause and not elsewhere, and that accordingly any promises or assurances made in the course of the negotiations (which in the absence of such a clause might have effect as a collateral warranty) shall have no contractual force, save insofar as they are reflected and given effect in that document.*

Therefore, this clause prevents the parties from relying upon any understanding or statements made, both oral and written, during negotiations and claiming that the agreed terms are different from the written contract. It ensures that all terms and conditions are captured in a single contractual instrument in its entirety. In a typical PE or an M&A transaction where the commercials and the transaction documents are heavily negotiated for a considerable period of time, it is critical for the investor that the written document prevails over any informal or separate discussions that may have taken place. Thus, it is important to have a well-drafted entire agreement clause that excludes any negotiations, claims, or representations made prior to the execution of the transaction documents and which clearly states that the transaction documents set out the entire understanding between the parties, whether oral or written.

Another example where the entire agreement clause attains importance is when the parties have entered into multiple agreements, and there exists a contradiction between the terms of the prior and the latest agreement. For example, the Hon'ble High Court of Bombay, in *Neelkanth Mansions and Infrastructures Private Limited and Ors. v. Urban Infrastructure Ventures Capital Limited and Ors.*<sup>3</sup>, stated that the shareholders' agreement in question, which had the 'entire agreement' clause, constituted and represented the entire agreement between the parties and had cancelled or superseded all prior arrangement, agreements or understandings. In another case, in the context of a share transfer agreement, a party justified its failure to purchase the shares by reading into the contract, based on negotiations, a contingent condition of listing of the shares before the trigger of the purchase obligation. The entire agreement clause came to the aid of the shareholder, as it precluded any contingent condition to be read into the contract.<sup>4</sup>

Given the considerable importance of an entire agreement clause, we need to be mindful about certain pointers while drafting this clause. Suppose the contracting parties intend to be bound by any term sheet or other documents

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they entered before executing the final agreement, in that case, parties should state in the agreement that the entire agreement clause does not exclude them. If parties enter into any 'side letters' under a transaction, then the parties should give conscious thought to whether such side letters should be referenced in the entire agreement clause as constituting a part of the understanding between the parties. An interpretational issue could arise as to whether such side letters would be binding on the parties if they are not included as forming part of the transaction in the entire agreement clause. Further, courts have the discretion to imply a term into a contract to fill in gaps. This process of implication of terms results in a subjective exercise where the court evaluates how a reasonable and officious bystander would address the gap in the contract. An entire agreement clause that expressly excludes implied terms could prevent such implication of terms in a contract.<sup>5</sup> Thus, the parties should cautiously consider the language of this clause with precise wording and context at the time of drafting.<sup>6</sup>

## NO WAIVER

A waiver is the act of voluntary relinquishment or surrender of some known right or privilege. A no-waiver clause is designed to prevent the parties from inadvertently waiving their contractual rights. This clause becomes relevant when one (aggrieved) party becomes aware that the other party has breached the agreement between the two parties. No-waiver clause makes it difficult for a party to an agreement to claim that the aggrieved party has waived its rights concerning the breach committed by the other party claiming such waiver. Put another way, a no-waiver clause ensures that the terms and conditions of an agreement are not changed or modified unless both parties agree to the proposed change or modification in writing.

However, on certain occasions the courts have affirmed that a party to a contract may waive a contractual condition through its conduct or statements, even when that contract contains a no-waiver clause.<sup>7</sup> In *Tele2 International Card Company SA and others v. Post Office Ltd.*,<sup>8</sup> the post office sought to terminate the contract basis a breach that had occurred on the part of Tele2 an year ago. Although the post office was aware of the said breach since the beginning, it chose to continue with the contract until the dispute where the post office took the argument that it was relying on the no-waiver clause to enforce its right to terminate after a period of 1 year. It was argued that the post office had not elected to affirm the agreement by conduct, basis which the court termed the termination by post office as a repudiatory breach and held that Tele2 was in principle entitled to claim damages. The court also clarified that a "*no-waiver clause does not remove the obligation of the aggrieved party to make an election*". Therefore, it is imperative that the party affected by the breach acts immediately to protect its rights, as any action inconsistent with the same maybe later construed against the aggrieved party.<sup>9</sup> However, the above departure does not indicate a trend of reducing effectiveness of no-waiver clauses, rather it simply indicates that the aggrieved party should avoid taking actions that could be seen by the other party as waiving or modifying the terms of an agreement.

The presence of a no-waiver clause raises the bar high to prove whether the evidence of any informal waiver or modification is sufficient to establish that the parties have subsequently overridden the terms of the original contract.<sup>10</sup> The courts have interpreted the no-waiver clause as yardstick to determine whether a party has actually waived or modified/amended the terms and conditions of the contract. In the case of *MMB Business Exchange Centres Ltd. v. Rock Advertising Ltd.*, the Supreme Court of UK, while interpreting a no-oral modification and a no-waiver clause held that, at the very least, (i) there would have to be some words or conduct unequivocally representing that the variation was valid notwithstanding its informality; and (ii) something more substantial would be required for this purpose than the informal promise itself.<sup>11</sup> Hence, it would not be easy for the courts to arrive at a conclusion that a party has waived their rights given the presence of this clause.

In the context of private equity investments, we often come across situations where during the routine working of the company, the quorum requirements for board meetings or investor consent requirement for reserved matter items are sometimes not adhered to. Typically, investors would not like to call default or raise issues unless they perceive the conduct in the circumstances to be egregious. In such situations, a no waiver clause protects the investors and ensures that the quorum/consent requirements remain effective and that the non-invocation of default in any one instance does not adversely impact the rights.

## SEVERABILITY

A severability clause removes certain terms from the contract if such terms are illegal, invalid, or unenforceable due to the operation of law. In doing so, the severability clause preserves the remainder of the contract as valid and enforceable, thereby making the enforceable terms independent of such unenforceable terms and/or their severance. However, severance of a few terms may potentially alter the underlying material objective/ meaning of a contract. In order to prevent such material change, ideally, severability clauses also contain reformatory language, i.e., it provides for a mechanism through which the parties may "*re-negotiate in good faith and modify the contract to effect the original intent of the parties as closely as possible*" in the event of severance.

Normally, the courts apply the '*blue pencil*' test to weed out the unenforceable terms of the contract. According to the Black's Law Dictionary, the *blue pencil* test is a judicial standard for deciding whether to invalidate the whole contract or only the offending words. This test was devised by the English courts in the case of *Mallan v. May*,<sup>12</sup> for determining whether striking out words from a contract containing unreasonable provisions would leave behind any substantial contractual obligations or not.<sup>13</sup> The courts have held that only those terms can be severed, which are non-essential in nature and do not materially affect the essence of the agreement between the parties<sup>14</sup>. However, if the offending provision is essential to the contract then the entire contract is set aside due to its invalidity.<sup>15</sup> In doing so, the courts also heed to the intention of the parties,<sup>16</sup> questioning whether the parties would have entered into the contract in the absence of such unenforceable provision, the severance of which is impugned.<sup>17</sup> The courts have also held that severance of such non-essential terms, does not cause the rest of the valid and enforceable provisions to fail.<sup>18</sup>

A modern view of the severability rule was laid down in *Sadler v. Imperial Life Assurance Co. of Canada Ltd.*<sup>19</sup>, where the court stipulated that a contract comprising of an unenforceable term nevertheless remains effective after the removal or severance of that term if the following conditions are satisfied: (i) the unenforceable term is capable of

being removed without the necessity of adding to or modifying what remains; (ii) the remaining terms continue to be supported by adequate consideration; and (iii) the removal of the unenforceable provision does not so change the character or the essence of the contract. In the Indian context, Sections 57 and 58 of the Indian Contract Act, 1872 applies the rule of severability to reciprocal<sup>20</sup> and alternative promises<sup>21</sup>, thereby rendering the illegal terms of a contract/promise as void and unenforceable, whilst accepting the validity and enforceability of the rest of the terms.

Sometimes, however, the courts intervene more than required, adversely interpreting the impugned clause or invalidating the same without ascertaining whether such clause is essential to the terms of the contract. Therefore, a severability clause assumes importance when the invalidated or unenforceable term is essential to the transaction.<sup>22</sup> A robust severability clause anticipates and precludes an undesirable judicial scrutiny/outcome while protecting the whole agreement from the repercussions of an unenforceable term by severing such term or part thereof. Therefore, it is advisable, as a drafting solution, to tailor such clauses to the needs of the parties by expressly identifying provisions that are essential to the transaction and which clauses can be invalidated if need be. A suggestive language for such clause can be as follows, “*if any provision or partial provision of this agreement, except for Article [...] (Indemnification), Article [...] (Liquidated Damages), for any other provision found by a court to be essential to the agreement, is found to be illegal, invalid or unenforceable for any reason, it shall be deemed to be severed from this Agreement; and the remaining part of such provision and all other provisions of this Agreement shall continue to remain in effect.*”

The existence of a severability clause could also simplify the exercise of the court in preserving a portion of the contract which gives effect to the intent of the parties as seen in *Shin Satellite Public Co. Ltd. v. Ms. Jain Studios Limited*.<sup>23</sup>

## CONCLUSION

Parties should be cautious while drafting boiler plate provisions in their contracts. These clauses have a great impact on the implementation of other provisions of the contract that may have been heavily negotiated and carry substantive rights of the parties. Given the fact that such clauses are usually the first port of call once a dispute arises and tend to ensure primacy and enforcement of the written word, the use of well drafted provisions could significantly reduce the time and money spent in resolution of disputes.

— Vardhika Sharma, Vasavi Kaparthi, Ashish Kabra & Harshita Srivastava

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<sup>1</sup> *MacMillan v. Kaiser Equipment Ltd.*, [2004] BCJ 969.

<sup>2</sup> [2000] 2 Lloyd's Rep 611 (at 614)

<sup>3</sup> Commercial Arbitration Petition Nos. 13, 38, 39, 40, 42, 43, 44, 45, 46, 48, 49, 50, 52, 53, 54, 55, 56, 58, 59, 60, 62, 65, 66, 67 and 68 of 2017, decided on December 7, 2018 by the High Court of Bombay.

<sup>4</sup> *Lee Chee Wei v. Tan Hor Peow Victor and others and another appeal*, [2007] SGCA 22

<sup>5</sup> *Meow Moy Lan and others v. Eksklusiv Resorts Pte Ltd and another*, [2021] SGHC 155; *Ng Giap Hon v. Westcomb Securities Pte Ltd and others*, [2009] SGCA 19.

<sup>6</sup> *Lee Chee Wei v. Tan Hor Peow Victor and others and another appeal*, [2007] SGCA 22;

<sup>7</sup> *Hovnanian Land Investment Group, LLC v. Annapolis Towne Centre at Parole, LLC*, 415 Md. 337 (2010)

<sup>8</sup> [2009] EWCA Civ9

<sup>9</sup> *Supra* at 7.

<sup>10</sup> *Virulite LLC v Virulite Distribution Ltd.*, [2014] EWHC 366 QBD

<sup>11</sup> [2019] AC 119

<sup>12</sup> (1844) 13 Meeson & Welsby 511

<sup>13</sup> *Nordenfelt v. Maxim Nordenfelt Guns and Ammunition Co Ltd.*; [1894] A.C. 535; *Attwood v. Lamont*, (1920) 2 KB 146.

<sup>14</sup> *BOI Finance Limited v. Custodian and Ors.*; (1997) 10 SCC 488.

<sup>15</sup> *Miller v. GGNSC Atlanta, LLC*, 746 S.E.2d 680 (Ga. Ct. App. 2013); *Small v. Parker Healthcare Mgmt. Org., Inc.*, 2013 WL 5827822 (Tex. Ct. App. 2013); *Hill v. Nares & Addresses, Inc.*, 571 N.E.2d 1085 (Ill.Ct. App. 1991).

<sup>16</sup> *Shin Satellite Public Co. Ltd. v. Ms. Jain Studios Limited*, Arbitration Petition 1 of 2005; SC Judgement dated 31.01.2006; *Schilling v. Harris*, 747 S.E.2d 833, 837 (Va. 2013); *Jacobs v. CNG Transmission Corp.* (Pa. 2001); *VICI Racing, LLC v. T-Mobile USA, Inc.*, (3d Cir. 2014)

<sup>17</sup> *Panasonic Co. v. Zinn*; 903 F.2d 1039 (1990)

<sup>18</sup> *Babasaheb Rahimsaheb v. Rajaram Raghunath*, AIR 1931 Bom 264

<sup>19</sup> [1988] IRLR 388

<sup>20</sup> Section 57, Indian contract Act, 1872

<sup>21</sup> Section 58, Indian contract Act, 1872

<sup>22</sup> ‘Drafting a Better Severability Clause’ Article by E. Fishman, and R. James (2013). [online] available at:

<https://www.pillsburylaw.com/images/content/4/4/v2/4483/Article20131001DraftingaBetterSeverabilityClause.pdf>.

<sup>23</sup> Arbitration Petition 1 of 2005; SC Judgement dated 31.01.2006.

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