

Module 4

This is a free reading resource for our Contract Drafting and Negotiation course.

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Drafting of Agreements: Preliminary Terms

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1. Introduction

After understanding the basics of what a contract is, and what all can go before drafting of a contract (such as pre-contractual instruments), we now come to the basics of contract drafting!

Legal drafting is a skill that is the bread and butter of any lawyer (be it a litigating lawyer or a corporate lawyer). As the Latin maxim goes, “*verba volant, scripta manent*”. This means that *spoken words fly away, written words remain!*

You might wonder why can't / shouldn't there be a handshake deal since oral agreements are also valid under Contract law? Why should one get involved with negotiations, the nitty-gritty of drafting, engaging lawyers and spending money on them?

Some of the basic problems with handshake deals are a **lack of clarity, certainty and completeness**. It also allows leeway for the parties to **go back on terms more easily**.

A well-drafted legal contract helps because it provides clarity, completeness, greater **enforceability** and effectiveness to the proposed transaction. Surely, a multi-million dollar deal, such as the acquisition of Jaguar and Land Rover by the Tatas, could not have been concluded simply on the basis of a handshake deal. The more complex a transaction, the greater the number of nitty-gritties.

Legal drafting is an effective mode of legal communication. A well-drafted contract conveys the message that you are trying to communicate clearly and completely.

Let us consider a simple illustration:

Suhas is the owner of a factory which manufactures jeans and t-shirts. Suhas has decided to sell 500 pieces of jeans to Tom. Tom owns a shop which sells jeans. Tom has provided some specifications of the jeans to be manufactured by Suhas. At the time of entering into the contract, the following clause was drafted:

Suhas agrees to sell and deliver jeans to Tom. (Note: We'll mention the clauses being discussed in red for ease of reference).

There are a number of problems with the above clause:

The number of jeans has not been specified, the time period within which the goods will be delivered is not mentioned, the place of delivery is not clear and even the specification of the jeans to be sold by Suhas is entirely missing. These are only some of the basic points that are missing. Such a vague clause can result in a potential dispute between Suhas and Tom, if Suhas ends up selling the goods which do not correspond to the requirements of Tom. Therefore, let us see how can this clause be made clearer and more effective (and we start learning contract drafting with this):

Suhas agrees to sell and deliver to Tom 500 pieces of jeans manufactured at Suhas' manufacturing unit within 90 days of execution of this Agreement. The said jeans will have the specifications set out in Schedule A and will be delivered at Tom's retail store in South Extension Part I, New Delhi.

An exercise for you to be put on the discussion forum:

- 1. Is there anything in the above example that is missing? What all can you think of?***
- 2. How would you draft this simple clause?***

Therefore, learning legal drafting is one of the key tricks of the trade. It is important to understand what constitutes a good, legally enforceable contract, and what are the key elements of a well-drafted contract.

2. Preliminary terms of an Agreement

Before getting into drafting the operative clauses of an agreement, certain preliminary terms are included. This includes the title to the agreement, description of parties to the agreement, the recitals which explain the reasons for entering into the contract and a section on definitions and interpretation of the contract. These are explained in more detail below:

a. Title

This helps in defining what is the nature of the agreement that the parties are looking to execute. For example, your client wants to **purchase the shares** of another company. By simply calling a document the Contract or Agreement is not helpful. Except for the draftsman, everyone will have to read the contract entirely to understand the nature of the contract. If you name the agreement '**Share Purchase Agreement**', it becomes clear that the agreement contemplates purchase and sale of shares by the parties.

It is equally important to provide the correct title to your contract. If your client is looking to enter into a joint venture with another person, you cannot name the contract as a partnership agreement, as it will start giving different connotations. Partnership has a distinct definition under the law and is different from a joint venture. Using the **right terminology** is very important to convey the correct meaning and arm the parties with commensurate legal rights and obligations.

Although, the general principle of interpretation is that of substance over form and therefore one can argue that what name you give to a particular contract is not that material – still the idea is to avoid any confusion/disparity. Having said that, headings or titles can serve as aids during the interpretation of a clause.

However, if the **heading and the substantive content** of the clause are different, the substantive content will prevail and be taken into account for interpretation of the exact nature of the clause. We will see more on this below.

b. Preamble

The title is usually followed by the preamble to the agreement. The preamble states the following:

- Name of the agreement

- Abbreviation of the agreement, if any
- Date of execution
- Place of execution

A sample preamble would look like:

This Share Purchase Agreement (SPA) is executed in New Delhi on July 20, 2019.

c. Date and Place of Execution

i. Date of Execution

The date of the agreement is an extremely important element. When we mention the effective date of the agreement, it helps in binding the parties to the obligations undertaken by them. The date of an agreement is also important in case the agreement has to be compulsorily registered under the **Registration Act, 1908**.¹ We will learn more about this in the Module – 7 on ‘execution formalities and processes’.

You may wonder: does this mean that all parties have to execute an agreement on the same day? What about contracts which are multi-jurisdictional? In such cases, it may not be logistically possible to have all the parties at the same place on the same date for executing the agreement. **The normal practice** in such cases is to date the agreement after the last party signs the agreement.

Going back to our example of Tom and Suhas – if Suhas executes the agreement on July 5, 2019, and Tom executes the same agreement on July 6, 2019, the agreement can be dated as of July 6, 2019. If you are drafting a

¹ Section 17 of Registration Act, 1908 specifies the list of compulsorily registrable documents. Section 23 of the said Act provides a time period of 4 months from the execution of the document for registering such document. The document is registered with the Sub-Registrar of Assurances.

contract which involves multiple signatories who are located in different locations, a similar approach is to be followed.

However, the above cannot be a thumb rule. It is possible that for some agreements, the parties to it sign the agreement for the sake of formality.

For example, if Atul who has shares in a company called ABC Ltd. is selling 2% of his take to Rahul, ABC Ltd. may sign the share purchase agreement in the capacity of a confirming party. Now, ABC Ltd. may decide to sign the agreement at a later date while Atul and Rahul may execute it on the same day. In such a case, the date on which ABC Ltd. (confirming party) signs the agreement will not be taken into account to determine the actual date of execution.

Execution date v. Effective date

It is possible that an agreement can come into effect as soon as the agreement is executed OR with retrospective effect OR from a date later than the execution date.

If the agreement is coming into effect from a date which is later than the execution date, it is called an **Effective Date: this is the date decided from when the agreement is effective.**

In the absence of a definition of Effective Date, the agreement will come into effect from the **date of execution**. However, it may be prudent to **clearly spell out the effective date to avoid any confusion**.

Let's consider a sample clause from a Joint Venture (JV) Agreement. The parties have agreed that the agreement will come into effect from the date of capital infusion by the parties in the JV entity. In such a case, the preamble of the agreement will refer to the execution date and a separate clause will be provided which will indicate the effectiveness.

For example:

Preamble: This Joint Venture Agreement is executed on July 6, 2019, at New Delhi.

Effectiveness: This Joint Venture Agreement shall come into effect from the date on which capital infusion in the JV entity is completed by the parties to this Joint Venture Agreement.

ii. Place of Execution

A key element for drafting any agreement is to determine where such agreement will be executed. The reason – usually the place of execution determines the **stamp duty** payable on the agreement. If a share purchase agreement is executed in New Delhi, then the stamp duty applicable in New Delhi shall be paid. However, if the agreement is executed in Mumbai, the applicable duty in Maharashtra will be paid.

Now, what happens when the parties signing an agreement are located in different places? How will you determine the place of execution and calculate the stamp duty? We will explain this in detail in the Module – 7 on ‘execution formalities and processes’.

The place of execution also helps in structuring a transaction. Different states in India have different stamp duties for the same instrument. As a lawyer, it is often your responsibility to suggest the place of execution which is the most **stamp duty efficient**. Of course, you shall attempt to do this only if the stamp duty payable is of a consequential amount. Again, this cannot be the rule of thumb: certain agreements (such as those pertaining to a mortgage of land) may have to be necessarily executed where such land is located. In such a case, the parties have no choice but to pay the applicable stamp duty.

d. Identification of Parties

It is important to identify who the parties are to a contract. The description of the parties should provide adequate information about them. This is to ensure that any party can be **identified and located easily**, as and when needed. It is also important to ensure that true and correct details of the parties are incorporated.

What information do you require for identifying the parties?

i. Individuals

- Complete name (as per official documents – usually PAN, Aadhar, passport or voter ID)
- Father's name
- Permanent address
- PAN number/Passport number/Aadhar number/GST registration number (as may be applicable)
- Director's Information Number (if applicable)

A sample description of an individual who is a party to an agreement would look like below:

Mr. Suhas Sinha, son of Mr. [insert name] an Indian citizen and tax resident in India, having passport number [insert] and residing at [insert] (hereinafter referred to as "Party A", which expression shall, unless it is repugnant to the context or meaning thereof, be deemed to mean and include his heirs, executors, administrators, permitted assigns and legal representatives);

ii. Company/LLP/Firm or other entities who are not individuals

- Registered address
- Email ID
- PAN
- Corporate Identification Number (for companies and LLPs)
- Registration Number (for Firms)
- GST registration number

A sample description of an entity who is a party to an agreement would look like below:

ABC Private Limited, a company incorporated under the laws of India bearing CIN [insert] and having its registered office at [insert address] (hereinafter referred to as “Party B”, which expression shall unless repugnant to the context or meaning thereof be deemed to mean and include its successors, administrators and permitted assigns);

Impersonation of parties is a problem that has plagued commercial transactions in India for a long time. This led to a situation where the supposed signatory had no idea that he or she had executed a document. To curb this issue, it is mandatory to provide pictures and thumb impressions along with signatures when a document is registered with the registration authorities.

You will also notice a deemed inclusion of successors, heirs, administrators or permitted assigns while identifying the parties. We shall elaborate more on this during our lecture sessions.

Small Tip 1: If one of the parties is a minor, and is being represented by a guardian acting under a will, the fact must be reflected in the description of the party.

Example:

Kavita, a minor, acting through Mr. Raj Singh who is her father and natural guardian...

Small Tip 2: If the trustees are entering into an agreement on behalf of the trust, the fact must be reflected in the description of the party.

Example:

Kiran and Pooja, trustees, representing PDP Trust, a trust formed under Indian Trusts Act

[kindly note that complete details of the trustees (i.e. the individuals) will have to be provided as indicated above].

e. Recitals

Recitals form the introduction to the story which will be presented through the contract. In other words, recitals **provide an introduction** and succinctly set out the essence of the contract, along with a brief background on what led to the contract.

Recitals act as an aid for a layperson to understand a complex contract which cannot be easily comprehended. Recitals may also help in introducing the parties, mention their business, highlight the transaction that the parties are planning to enter into, and also mention the intention of the parties to incorporate their understanding in the form of a written contract.

Typically, a recital will begin with a 'WHEREAS'

For instance:

WHEREAS Rajesh Gupta (Executive) is a qualified company secretary to serve as the Company's Secretarial and Compliance Officer; and

WHEREAS, the Company desires to appoint the Executive as the Company's Secretarial and Compliance Officer and to employ the Executive on the terms and conditions set forth in this Agreement; and

WHEREAS, the Executive desires to be so employed by the Company.

Even without reading the entire agreement, one has a fair idea that this is the recital of an employment agreement. Therefore, recitals form a really important element of a well-drafted contract. Broadly, recitals can be divided into two categories:

Narrative recitals: these recitals capture the history of the parties, the business they are engaged in and the previous discussions leading up to the contract.

Introductory recitals: these recitals explain the reason for the present agreement.

While drafting a recital, one should be mindful of the following:

- The narration should be good enough for the reader to understand how the parties have reached to carry out the proposed transaction. It is important to mention what is the transaction and what is the commercial understanding of the parties in relation to the transaction.
- Recitals should follow a chronological order.

- Do not include operative clauses such as representation and warranties or indemnities in the recitals (more about this later)!
- The use of recitals should be judicious. In the event recitals conflict with the operative clauses of an agreement, a potential dispute may arise.
- Where the operative part of the agreement is unambiguous, the recital alone cannot determine the purpose or intent of the contract.
- You can write recitals in a number of ways:

Start with “Whereas” and continue with “And Whereas” for the subsequent recitals OR write “Whereas” for the first recital and keep using a semicolon and write the rest of the recitals sequentially OR use the words “Background” or “Recitals” and simply record the background information.

- Ensure to number your recitals. You can either use numerals or alphabets.

Is it necessary for all contracts to have recitals?

While the usual practice is to record the recitals, parties may choose to omit recitals in certain agreements. For example, in the case of a loan agreement, once the lender and the borrower are identified in the array of parties, one can directly draft in the operative clauses without including separate recitals.

However, sometimes the nature of the document may require recitals as a matter of custom. For instance, in a sale deed, you will usually find recitals on how the property has been sold and purchased by various persons before reaching the current seller/owner. This is usually asked for by officials when you go to register the sale deed. It helps them to identify the trail and locate file numbers as well as see the authenticity of the transaction if required from previous records. It also helps at the time of getting the property mutated in the purchaser’s name in the municipal records.

f. Definitions and Interpretation

The main purpose of definitions and interpretation clause is to define the commonly used terms and phrases in the document and reduce repetition within the body of the agreement. This section is also used to attribute specific meanings to particular terms used in an agreement. For e.g., terms such as material adverse effect, confidential information, loss etc. may each have a commonly understood meaning, but these terms are heavily negotiated between the parties and are assigned specific meaning for the purpose of each contract. This is important as otherwise there is a risk of different interpretations in the event of a dispute between the parties.

It is common for the definitions and interpretation section to be included in the beginning of an agreement after the recitals. However, it can also be placed in a separate schedule to the agreement. The positioning does not have any bearing on its legal effect.

i. Definitions

If a term is not defined in the agreement, then such term or expression shall be given its ordinary or natural meaning. However, if by looking at the overall context of the agreement, it appears that the parties intended some other meaning, then the courts may require extrinsic expert evidence to interpret them.

Usually, the contract law does not go against any particular custom or trade of industry unless otherwise specified. Therefore, if the term relating to a particular trade is used in a contract which is not defined, it may require extrinsic expert evidence to interpret them. One can avoid this by simply assigning meaning to such terms.

Some of the drafting tips which should be kept handy while drafting the definitions section are as follows:

The following tips should be borne in mind when drafting defined terms:

- Definitions should be listed in alphabetical order so that it is easy for a reader to refer to individual definitions.
- A term that is defined in the operative clause of the agreement does not have to be re-defined in the definitions section. Such terms should be simply cross-referred in the definitions section. (for example, *Confidential Information has the meaning given in Clause [insert] of the Agreement.*).
- Each agreement is unique and the definitions used in a similar agreement in the past should not be copy-pasted without giving careful thought.
- Don't use the defined term in the definition itself! This will lead to a circuitous interpretation. (for example, avoid defining Confidential Information as *Confidential Information means the confidential information of a party.*).
- The first letter of each word of the defined term should be capitalized. This highlights the fact that a term carries a particular meaning.

ii. Interpretation

The interpretation section of a contract specifies the general or specific rules for interpreting the contract. If there is no agreed clause on the rule of interpretation between the parties, then the common law and statutory rules of interpretation will apply.

An interpretation clause often includes interpretation relating to the following aspects (however please note that by no means is the below an exhaustive list):

- **Headings:** Interpretation clause usually provides that headings should not affect the interpretation of any provision of the contract. Remember that the title of the agreement or a heading to a clause only provides guidance to the contents of the contract. The contents of an agreement or a clause will not be interpreted solely on the basis of its title. In fact, a good draftsman will ensure to include the following clause in the interpretation section of the agreement:

The headings and titles contained in this agreement are for reference purposes only and shall not affect the meaning or interpretation of this agreement.

- **Gender:** *A reference to one gender shall include a reference to the other genders.* This specifies that reference to any gender whether masculine or feminine includes references to other gender or people who do not identify themselves as male or female.
- **Singular and plural:** *Words in the singular shall include the plural and in the plural shall include the singular.* Such provisions usually just help in making the operative provisions more water-tight.
- **Days and dates:** The interpretation clause may specify that the days, months, year or any particular date mentioned in the contract should be as per the English or Gregorian calendar.
- **References to laws:** The interpretation clause also includes that a reference to a law includes references to any delegated legislations or rules and regulations framed thereunder. Further, at the time of interpreting such legislation, any amendment or re-enactment of such

laws shall also be taken into account. Imagine where you have to make a reference to a particular statute in the contract – for instance, Party A shall comply with the provisions of Income Tax Act, 1961 and thereafter Parliament overhauls the compliance in relating to that particular legislation by fresh enactment!

- **Clause referencing:** The interpretation clause can make it clear that a reference to a clause means a reference to a clause of this agreement. Accordingly, whenever a clause of the contract is being referred, the draftsman does not have to include the suffix ‘of this contract’ every time.
- **Undefined words:** The interpretation clause may specify that in case a particular word or phrase appears in the contract for which a definition is not provided for in the contract, then its meaning will be taken from particular legislation so far as the context permits.
- **Recitals, Schedules and Annexures:** The interpretation clause may specify that recitals, schedules and annexures are a part of the contract. It is rare for a party to suggest that they are not.
- **Ejusdem Generis rule:** This rule helps in narrowly interpreting lists and limits the interpretation of things which are of the same kind or nature. For e.g., if a contract defines the business of a company as a business of selling vehicles including automobiles, cars, motorcycles and other motor-powered vehicles, then as per the ejusdem generis rule, “vehicles” would not include airplanes since the list relates to modes of land-based transportation. The interpretation clause can exclude this principle of interpretation and provide for a broader interpretation which is not limited to the specific words.

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