

EXPLORATORY OR ENFORCEABLE? DELHI HIGH COURT CLEARS THE AIR ON NON-BINDING TERM SHEETS

The Delhi High Court (“**Delhi HC**”) has, *vide* its judgement dated May 13, 2025 (“**Ruling**”), in the case of *Oravel Stays Private Limited v. Zostel Hospitality Private Limited*¹, set aside an arbitral award that treated a non-binding term sheet as a binding document and granted the specific performance of certain obligations thereunder.

Case History.

This matter arose from a dispute between Oravel Stays Private Limited (“**OYO**”) and Zostel Hospitality Private Limited (“**Zostel**”) stemming from a term sheet dated November 26, 2015 (“**Term Sheet**”), executed between OYO, Zostel and two of Zostel’s shareholders namely, Internet Fund III Pte. Ltd., (Tiger Global) and Orios Venture Partners. The said Term Sheet contemplated acquisition by OYO of Zostel’s assets (including intellectual property, software, and key employees) in exchange of which: (i) Zostel’s shareholders were to receive 7% equity stake in OYO upon closing of the proposed transaction; and (ii) Zostel’s founders were to receive a payout of USD 1 million upon completion of the post-closing obligations.

Pertinently, the preamble of the said Term Sheet stated that it was non-binding in nature, except for specific provisions on confidentiality, approvals, expenses, exclusivity, governing law and arbitration, that were legally binding. The Term Sheet also stipulated the due execution of certain definitive documents, including a Share Subscription Agreement, Shareholders Agreement, and an Asset/Business Transfer Agreement, to give effect to the proposed transaction.

After execution of the Term Sheet, significant disputes surfaced between the parties with Zostel claiming that while it had fulfilled its obligations thereunder, which included facilitating the transfer of employees, properties, and customer data to OYO, OYO had failed to take requisite steps towards finalizing the acquisition process. However, OYO disputed the binding nature of the Term Sheet and asserted that it was intended only as a preliminary framework, which was later terminated.²

Consequently, Zostel initiated arbitration proceedings against OYO under the Arbitration and Conciliation Act, 1996 (“**A&C Act**”), seeking specific performance by OYO of its obligations under the Term Sheet and monetary damages for the loss of goodwill and reputation as well as inconvenience caused to Zostel. The arbitral tribunal, comprising of a sole arbitrator, under an award dated March 6, 2021 (“**Impugned Award**”), ruled in Zostel’s favour, holding that the Term Sheet became a binding document by virtue of the conduct of the parties³ and that Zostel was entitled to appropriate proceedings for specific performance and execution of definitive agreements, as envisaged under the Term Sheet. Interestingly, under the Impugned Award the arbitral tribunal determined that there was no *consensus ad idem* (*meeting of the minds*) between the parties as regards execution of any “definitive agreements” as contemplated under the Term Sheet.

Aggrieved by the above, OYO filed a petition under Section 34 (*Application for setting aside arbitral awards*) of the A&C Act, seeking to have the Impugned Award set aside.

Delhi HC Ruling.

¹ O.M.P. (COMM) 151/2021

² The Term Sheet was terminated in September 2016, by way of email exchanges between OYO and Zostel on September 17, 2016 and September 19, 2016.

³ On consideration of the Term Sheet as a whole, the arbitral tribunal was of the view that Zostel had taken various steps to fulfil its obligations thereunder and that although the preamble mentioned that the Term Sheet was non-binding, the clauses thereto clarified that the definitive documents were not independent of the Term Sheet. Thus, the arbitral tribunal held that the Term Sheet did contain a basic framework regarding acquisition and even if the parties assumed at the time of execution that it would be non-binding and exploratory, their subsequent conduct/ actions demonstrated a waiver of that intent, thereby creating a binding and enforceable contract.

The Delhi HC tested the Impugned Award on several key parameters/ principles, and in doing so examined questions pertaining to the legal validity and enforceability of term sheets, a brief synopsis of which is set out below:

1. Express Non-binding Clauses Prevail. The Delhi HC observed that the Term Sheet expressly and unequivocally stated that it is ‘*non-binding*’, and that only 5 clauses⁴ were to be treated as binding. In Delhi HC’s view, if the parties had intended for all provisions of the Term Sheet to be binding, they would not have included any explicit provisions to the contrary in the said Term Sheet. Further, the Delhi HC also relied on the judgement passed by the Division Bench of the Karnataka High Court in the case of *M/s. Azeem Infinite Dwelling v. M/s. Patel Engineering Limited*⁵, wherein it was held that a term sheet requiring execution of definitive agreements does not, by itself, create binding obligations unless explicitly intended.

Despite expressing reservations on the findings/ observation of the arbitral tribunal that had concluded that the Term Sheet had become a binding document by virtue of the conduct of the parties, the Delhi HC clarified that under Section 34 of the A&C Act it could not undertake a merit-based review, especially in the context of an international award. Hence, the finding/ observation regarding the binding nature of the Term Sheet was not interfered with.

2. Conduct of Parties Does Not Override Written Terms. The Delhi HC observed that while the arbitral tribunal did not hold that any implied term must be read into the Term Sheet in order to render it binding, it had instead held that the Term Sheet became binding due to the parties’ conduct. In this regard, the Delhi HC re-affirmed the position of law set out in the case of *Bank of India v. K. Mohandas*⁶, wherein it was held that the true effect of clear, and unambiguous words used in a contract is not affected by the subsequent conduct of the parties in the performance of such contract.
3. Omission to Adjudicate on Material Issue(s) — Renders the Arbitral Award Vulnerable to Challenge. The Delhi HC observed that, despite the arbitral tribunal holding the Term Sheet binding, it had failed to conclusively rule on a vital aspect — Zostel’s entitlement to specific performance for acquiring 7% shareholding in OYO as well as the payout of USD 1 million to Zostel’s founders. The Delhi HC remarked that though it was incumbent upon the arbitral tribunal to grant or deny specific performance based on its findings, it had instead improperly relegated Zostel to separate proceedings for specific performance and execution of definitive agreements. Additionally, the arbitral tribunal had overlooked OYO’s objections regarding the Term Sheets’ determinable nature, including evidence of Zostel’s acknowledgment of termination of the Term Sheet. The Delhi HC opined that this failure by the arbitral tribunal to adjudicate on material issues rendered the arbitral award vulnerable to challenge under Section 34 of the A&C Act.
4. Consensus Ad Idem is Essential. The Delhi HC held that the arbitral tribunal’s upholding of Zostel’s entitlement to seek specific performance, despite having itself noticed the lack of *consensus ad idem* in respect of crucial aspects of the transaction, violated the core principles of Indian contract law and conflicted with India’s public policy. In arriving at this conclusion, the Delhi HC primarily relied on two rulings, being *Mayawanti v. Kaushalya Devi*⁷ and *Usha Aggarwal v. The Punjabi Bagh Co-Operative Housing Society Limited and Another*⁸ wherein it had been held that the requirement of *consensus ad idem* is a necessary condition for specific

4 The following 5 clauses in the Term Sheet were binding in nature: (i) confidentiality; (ii) approval; (iii) expenses; (iv) exclusivity; and (v) governing law and arbitration.

5 MANU/KA/1320/2024

6 (2009) 5 SCC 313

7 (1990) 3 SCC 1

8 2018 SCC OnLine Del 8905

performance of contracts. Accordingly, the Delhi HC held that granting of specific performance by the arbitral tribunal in the absence of a complete agreement between the parties was contrary to the basic tenets of Indian law of contract and specific performance.

The Delhi HC ultimately determined that the Impugned Award was fundamentally flawed, citing serious deficiencies such as the failure to adjudicate on material issues, as well as conflict with fundamental principles that constitute the basis for administration of justice and enforcement of law and contracts in India. Accordingly, the Impugned Award was set aside under Section 34(2)(b)(ii) of the A&C Act on account of being in conflict with the "public policy of India".

Non-Binding Term Sheets - Mitigating Risks & Best Practices.

This Ruling serves as a cautionary tale for parties intending to enter into term sheets, underscoring the importance of precise legal drafting to avoid disputes over enforceability. In order to mitigate associated risks, the following strategies may be implemented:

1. Drawing clear distinction between binding vs. non-binding provisions. Considering courts have lent greater weightage to written agreements over the implied intent of parties, towards eliminating ambiguity, it is essential to explicitly delineate the provisions (within a term sheet) that are meant to be legally binding, and those that are intended to serve as a blue print of the preliminary understanding that would have to be translated into the final arrangement pursuant to negotiations between the parties, and ultimately crystallised in legally binding definitive agreements.
2. Strengthening disclaimers in term sheets. Merely identifying non-binding clauses in term sheets may not be sufficient, and a clear distinction between enforceable obligations and those that serve to outline the preliminary understanding between the parties is essential for legal certainty. Term sheets as a whole should imply the intention of the parties to not create any binding obligations, unless expressly converted into a formal agreement.
3. Aligning conduct with contractual language. While the Ruling clarifies that the conduct of parties alone does not create enforceable obligations, holding off on performing any obligations (for the completion of the transaction) until the definitive agreements are in place would ensure that a non-binding agreement is not cloaked as a binding document. Inserting detailed obligations in term sheets that are typically completed as a part of the closing of a transaction should be avoided. If such obligations are included in term sheets, a provision clarifying that performance or non-performance thereof (under such term sheet) does not impact its non-binding nature should be added.
4. Expediting the transition from a term sheet to a formal contract. To reduce the risk of disputes emanating from prolonged negotiations, parties moving swiftly towards execution of definitive agreements can ensure quicker deal closures with reduced reliance on preliminary arrangements.
5. Avoiding unintended consensus in correspondence. Any correspondence which implies a mutual agreement on all material terms (*consensus ad idem*) should be avoided to prevent the formation of a binding contract.

Conclusion.

While term sheets are recognized as the foundational framework of transactions, encapsulating the parties' shared vision and guiding the negotiation process, this Ruling affirms that term sheets remain

preliminary documents, that are contingent upon the execution of final, definitive contracts, except in cases where such term sheets itself create binding obligations.

Parties intending to enter into non-binding term sheets should ensure that such term sheets are drafted so as to serve as a blue print outlining the key terms of the proposed transaction, that are subsequently formalised under definitive agreements once they are aligned on the final understanding. Being mindful of the above should help to safeguard the interests of, and reduce the likelihood of future disputes between such parties.

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