

The usefulness of side letters has long been recognised in a landlord and tenant context, particularly in the retail sector. They allow concessions diverging from the parties' lease obligations, such as monthly rent payments or the rebalancing of insurance obligations, to be documented with the benefit of confidentiality and a personal agreement with that tenant, whilst avoiding the risk of the concession creating a precedent for other transactions and rent reviews.

However, the recent case of *Vivienne Westwood Limited v Conduit Street Developments Limited* [2017] EWCH 350 highlights the need for caution when drafting side letters, particularly where it documents a rent concession.

The decision is a useful reminder of the effect of side letters even where they expressly provide that they do not vary the lease. It provides welcome certainty for tenants that concessions granted and properly documented in a side letter are likely to be enforceable. However, landlords should review any termination provisions in side letters carefully to avoid any penalty arguments and ensure that they can legitimately operate as intended.

Where the concession being documented by the side letter is crucial to the agreement between the parties, the need for certainty over its enforceability is high. For example, in *Vivienne Westwood*, the payment of a lower rent was agreed in return for having a tenant with Vivienne Westwood's reputation.

A side letter, like any contractual document, needs to comply with the general rules relating to contract formation, such as an intention to create legal relations and the need for consideration. In *Vivienne Westwood*, it was accepted that a side letter entered into on the same day as the lease, by the same parties as part of the same leasehold transaction was enforceable to create a primary obligation between the parties. It is worth noting that this position is likely to be more difficult where the side letter is entered into after completion of the lease due to a lack of consideration.

The side letter in *Vivienne Westwood* conferred on the tenant the benefit of a lower rent than that required by the lease which was terminable by the landlord in the event of a breach by the tenant of *any* of the terms in the side letter, regardless of the impact or seriousness of the breach.

The court held that the right for the landlord to terminate the side letter in this way constituted a penalty clause. This was on the basis that the termination provisions provided that *any* breach, however small, would lead to the tenant being required to pay the higher rent from the commencement of the lease (i.e. retrospectively and not just from the date of the breach). The obligation to pay the higher rent was in addition to compensating the landlord for any loss caused by the breach itself. Such consequences were found to be excessive and out of all proportion to the landlord's legitimate interest to enforce the higher rent in the event of a breach by the tenant.

As a result, the termination provisions in the side letter were held to be unenforceable and the tenant was entitled to continue paying the lower rent whilst it remained the tenant of the property even if it breached its lease obligations.

If you would like to discuss any issues relating to side letters, or otherwise, please do not hesitate to contact a member of our Real Estate Litigation team.

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