

Insight

Insight provides practical information on topical issues affecting the building, engineering and energy sectors.

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Letters of Intent:
Avoiding those Bear
Traps



The use of letters of intent can be fraught with difficulty. In this *Insight* we review the key case law on letters of intent of the past few years and seek to highlight some of the lessons that can be learned from them.

Letters of Intent: Avoiding those Bear Traps¹

Introduction

Letters of intent are widely used in the construction industry as a way of letting procurement, site preparation or indeed construction works commence before the negotiations for the detailed construction contract have been completed. The exact form they take varies widely but, typically, they will provide for a contractor or subcontractor to start an aspect of their work associated with the project. They often expressly provide for a cap on value² or a drop dead date after which the letter of intent will no longer be valid. It is not uncommon to see such limits repeatedly increased or revised letters of intent being issued, as the contract negotiations between the parties drag on. In one case Fenwick Elliott advised on, 27 separate letters of intent had been issued and the construction contract had still not been signed.

Many commentators (with good reason) advise against the use of letters of intent³ and they are frequently criticised for not being used with “adequate care and attention” by contractors and employers alike.⁴ Too often they are used because people are used to using them, and consider them to be part of the process, rather than because they actually need to use them. It is also not uncommon for the lawyers to be called in too late, i.e. to interpret what has already been written and agreed rather than to write the document itself.

However, the commercial reality is that sometimes, in order to keep a programme on track, letters of intent do need to be used. It is with this in mind, that we will look at some of the lessons emerging from recent cases and then suggest some practical tips for those considering or entering into a letter of intent.

Is there a contract?

Perhaps the most common argument running through the cases is whether any binding contract has been reached as a result of the letter of intent. Various tactics are sometimes used by parties to try and avoid a binding contract being reached. A classic tactic used by contractors and their non-legal advisors is marking the letter of intent “Subject to Contract”.

RTS v Muller

The leading case on this remains the Supreme Court case of *RTS Flexible Systems Ltd v Molkerei Alois Muller GmbH & Co. KG*.⁵ In the opening paragraph of his judgment Lord Clarke noted:

*“The different decisions in the courts below and the arguments in this court demonstrate the perils of beginning work without agreeing the precise basis upon which it is to be done. **The moral of the story is to agree first and to start work later.**”* [Emphasis added]

The case involved a letter of intent marked expressly “Subject to Contract” which also had an expiry date, and the question of whether the contract did or did not incorporate the MF/1 conditions.

Lord Justice Clarke summarised the principles as to whether or not there was a binding contract, and, if so, what the terms might be as follows:

*“45... It depends not upon their subjective state of mind, but upon a consideration of what was communicated between them by words or conduct, **and whether that leads objectively to a conclusion that they intended to create legal relations and had agreed upon all the terms which they regarded or the law requires as essential for the formation of legally binding relations.** Even if certain terms or economic or other significance to the parties have not been finalised, an objective appraisal of their words and conduct may lead to the conclusion that they did not intend agreement of such terms to be a precondition to a concluded and legally binding agreement.”* [Emphasis added]

In the *Muller* case, the Supreme Court held that the contract included the MF/1 conditions (as amended). Whilst there were some terms still to be agreed, those terms were not essential and did not prevent a contract existing. By their conduct, the parties had affirmed the existence of the contract by carrying out the works, making payments, and by varying the contract. In agreeing the variation to the delivery programme, the parties were implicitly accepting that there was a contract already in place and to deny the existence of one would therefore make no commercial sense.

Finally, the Supreme Court decided that the requirement that the contract had to be signed before it became effective had been waived by the parties. The Court held that no reasonable businessman would have felt, at the relevant date, that there was no contract in place between the parties.

Marking something “Subject to Contract” does not then mean that there is in fact no contract.

*Arcadis v AMEC*⁶

In the more recent case of *Arcadis Consulting (UK) Limited v AMEC (BSC) Limited*,⁷ the issue as to whether there was a contract also came into play, with the Judge (Mr Justice Coulson) citing paragraph 45 of *RTS v Muller* in reaching his conclusion.

In this case Buchan (AMEC), who acted as the specialist concrete subcontractor, engaged the Claimant known as “Hyder” to carry out certain design works on a car park in anticipation of a wider agreement between the parties that did not materialise. It was alleged that the car park was defective and might need to be demolished and rebuilt at significant cost. Hyder denied liability but also said that if they were liable, there was a simple contract in respect of their design works, pursuant to which their liability was capped in the sum of £610k.

Buchan argued that there was no contract because the correspondence envisaged a formal Protocol agreement with detailed terms and conditions. The absence of a final Protocol agreement precluded the existence of any contractual relationship between the parties.

As Mr Justice Coulson stated:

*“In circumstances where works have been carried out **it will usually be implausible to argue there was no contract.**”* [Emphasis added]

This was a case where work was done and paid for on the basis of instructions from Buchan, which were accepted by Hyder. It was not a case in which any of the relevant correspondence was marked “Subject to contract”. Instead, works were performed on the express understanding that, if the anticipated detailed contract did not come to pass, the correspondence between the parties would create a legal relationship between them and ensure that, amongst other things, Hyder would be paid for the work it undertook.

There was an instruction, and the fact that Hyder carried out the design work pursuant to that instruction evidenced a contract between the parties. The Judge therefore held that there was a binding, simple contract between the parties.

Overview

Theoretically, then, whilst it is possible to have non-contractual letters of intent (defined by Chitty on Contracts as “the expression of intention by A to enter into a contract with B at some time in the future, coupled with an indication from A to B that B should commence work”⁸), the reality is different. If the works have been started then it is extremely likely that a contract will be found to exist.

So what are the terms?

The key question then turns to “so what are the terms of the contract?” The complications that can be associated with letters of intent often revolve around this seemingly basic question. All too often not enough thought has gone into what will happen if the contract is not concluded. It is then that the ambiguity and uncertainty can often wreak havoc and legal costs start to mount.

Arcadis v AMEC yet again provides a classic example of what not to do. In that case there were three competing sets of terms and conditions which Hyder had very carefully made sure it did not accept. In retrospect Hyder desperately wanted the liability to apply. Unfortunately for them, Mr Justice Coulson considered that there was too much uncertainty and too much that was not agreed for the court to conclude that the parties intended to be bound by a liability cap in the way Hyder alleged. He noted that:

*“Whilst the court should always strive to find a concluded contract in circumstances where work has been performed ... **the court is not entitled to rewrite history so as to incorporate into that contract express terms which were not the subject of a clear and binding agreement.**”* [Emphasis added]

Whilst the Judge acknowledged that this might be regarded as a harsh result, he felt that he was bound to conclude that:

“this was the inevitable consequence of Hyder’s dilatory and often uncooperative approach to the proposed Protocol agreement and the negotiation of the terms and conditions. This case starkly demonstrates the commercial truism that it is usually better for a party to reach a full agreement (which in this case would almost certainly have included some sort of cap on their liability) through a process of negotiation and give-and-take, rather than to delay and then fail to reach any detailed agreement at all.”

As can be seen from this quote, the Judge was clearly not impressed with Hyder’s conduct.

*Ampleforth v Turner and Townsend*⁹

In the earlier case of *Ampleforth v Turner and Townsend* a failure to agree a detailed contract resulted in the Employer being unable to levy liquidated damages during the currency of the contract. As a result of this, the settlement *Ampleforth* reached with the Contractor (Kier) was, they claimed, lower than it would have been otherwise. They then claimed against their advisors, arguing that they had been negligent in failing to advise of the risks associated with letters of intent and closing out the terms of the contract (which they were successful in arguing).

Am I still working on the letter of intent or am I now working on an agreed construction contract?

The case of *Spartafield v Penten Group*,¹⁰ which was finally determined in September last year, further underlines the dangers of letters of intent. In that case both parties had already been through the adjudication process earlier in the year.¹¹ A key issue in the case was whether the letter of intent governed the relationship between the parties, or an unsigned new contract incorporating the JCT ICD Conditions had been entered into. In the end Mr Alexander Nissen QC (sitting as a Deputy Judge) determined that a new contract had been entered into despite there being no signed contract. He determined that although it was the parties’ intention to sign a construction contract, it was never made a precondition to the formation of a replacement contract that it should be formally executed.

Before they got to this judgment, the parties had been involved in a three-day hearing as well as numerous adjudications and enforcement proceedings.¹² Clearly, this was in no one’s interests, but the case underlines the dangerous ambiguities that can accompany the use of letters of intent.

Other potential difficulties

There are numerous other difficulties potentially associated with letters of intent. Some key ones to think about include:

- 1 What happens to the contractor’s tender submission? Is it still open for acceptance or does the let-

ter of intent (depending on its contents) constitute a counter-offer which opens the door to the Contractor to renegotiate the submission at a later date, e.g. its price, programme etc.? It can be worth stating expressly that the Contractor's tender remains open for acceptance to avoid this issue arising.

2 Does the letter of intent as drafted incorporate the underlying terms? If it does, have the Contract Particulars been filled? Perhaps not if the contract terms haven't been agreed. Does this mean the terms don't work (for example, in relation to the insurance position)? Presumably if the construction contract is still being negotiated some of the terms proposed by the Employer were not acceptable. Does the letter of intent incorporate these terms as well?

3 What happens once the cap and/or time period in the letter of intent is exceeded? In *Diamond Build v Clapham Park Homes*¹³ the courts did not order payment to be made beyond the cap despite extra work being undertaken by the Contractor.¹⁴

4 Is there an express right within the letter of intent for the Employer to instruct the Contractor to carry out more work, or can they simply decide to walk off if they wish to?¹⁵ If there isn't an express right to instruct more work, what is to stop the Contractor walking off site if terms can't be agreed? Letters of intent frequently state there is no obligation on an Employer to instruct more work under the letter of intent. Where does this leave the Contractor?

5 What is the position with regard to insurance? If you are the Contractor or Subcontractor, what is the insurance position? If you were to cause a fire or flood in the building you are working on (for example, whilst commencing stripping out works for an interior fit-out), would you be liable for all the loss or will the Employer's insurance cover you for the losses? If you're the Employer, does the Contractor or consultant have the insurance you think they do or have an obligation to procure it?

All too often in our experience the points above are not properly considered. With this in mind, we set out some practical tips for those considering using a letter of intent.

Some practical tips

First, before deciding to agree a letter of intent both parties should stop and ask themselves why a full contract cannot yet be entered into. If the answer is that there are still difficult points of negotiation to be agreed between the parties, then entering into a letter of intent is unlikely to make these difficult issues go away. From an Employer's perspective it places them arguably in a weaker bargaining position as the Contractor is on site and works are under way. From a Contractor's perspective there is always a risk that the Employer will decide to use someone else, which they are likely to be able to do if, for example, the letter of intent provides for an express expiry date or a cap on the amount that can be incurred under the contract in question.

If there is no choice but to enter into a letter of intent, approach it on the assumption that the main contract may never end up being agreed. What are the key essential terms you need in that letter to ensure you don't face years of litigation along the lines of *Muller v RTS or Arcadis v AMEC*?

Once you have a letter of intent in place, don't stop progressing towards agreeing the main contract. Professional advisors should also be sure to press for the construction contract to be finalised and warn of the dangers of this not being done.

Although it may seem beneficial not to agree terms at the time, the advantage of having clear contract terms is that you know what your commercial risk is. A limitation of liability, for example, gives you certainty as to what your maximum liability will be if a worst case scenario occurs.

As noted by the Judge in *Ampleforth v Townsend and Turner*:

*"efforts to finalise the contractual arrangements were of central importance. The execution of a contract is to be seen not as a mere aspiration but rather as fundamental. It is the contract that defines the rights, duties and remedies of the parties and that regulates their relationships. Standard-form contracts, such as the JCT contracts, are precise, detailed and structured documents; their elaborate nature reflects the complexities of the projects to which they relate and attempts to address the many and varied problems that can arise both during the execution of the works and afterwards. **By contrast, letters of intent such as those used in the present case are contracts of a skeletal nature; they pave the way for the formal contract, once executed, to apply retrospectively to the works they have covered, but they expressly negative the application of most of the provisions of the formal contract until it has been executed. They do not protect, and are not intended to protect, the employer's interests in the same manner as would the formal contract; that is why their 'classic' use is for restricted purposes.**"* [Emphasis added]

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March 2017

Footnotes

1. With thanks to Dave Bebb and Ed Colclough for their practical tips, and Laura Bowler for her legal research on this topic.
2. See for example the cap provided for in the letter of intent at issue in the recent case of Spartafield Limited v Penten Group Limited [2016] EWHC 2295 (TCC).
3. See the City of London Law Society Standard Form Letter of Intent Guidance Note for example.
4. Arcadis Consulting (UK) Ltd v AMEC (BSC) Ltd [2016] EWHC 2509 (TCC) at para 53.
5. [2010] UKSC 14.
6. For a detailed review of this case see Jeremy Glover's article in Dispatch dated 3 November 2016.
7. [2016] EWHC 2509 (TCC) at paragraph 51.
8. Chitty on Contracts, 32nd edition, Sweet and Maxwell, chapter 37-060, as well as Sarah Fox's SCL Paper "Can letters of intent help you avoid lawyers?", November 2016, for further discussion in relation to this.
9. Ampleforth Abbey Trust v Turner & Townsend Project Management Ltd [2012] EWHC 2137 (TCC). See Jeremy Glover's detailed note on this case in Dispatch, August 2012.
10. Spartafield Limited v Penten Group Limited [2016] EWHC 2295 (TCC).
11. See Penten Group Ltd v Spartafield Ltd [2016] EWHC 317.
12. Mr Alexander Nissen QC noted that "In his Judgment Coulson J described the 'almost maniacal desire of the parties to issue notices of adjudication against each other' and that 'this impulse seems to have overwhelmed every other consideration'. It is fair to say that the proceedings brought before me were conducted with no less vigour than was apparent to him at the time." (See paragraph 5 of his judgment.) For more detailed analysis see *ibid*.
13. [2008] EWHC 1439 (TCC).
14. The letter of intent in this case set out when the works were to commence and the Contract Sum, and also stated that (i) it was CPH's intention to enter into a contract with DB on the basis of the JCT Intermediate Form of Contract, 2005 edition, with further amendments as specified in the Specification; (ii) should it not be possible for CPH and DB to execute a formal contract in place of the letter of intent then CPH would reimburse DB their reasonable costs up to and including the date on which DB was notified that the contract would not proceed provided that the Supervising Officer was satisfied that those costs were appropriate and that in any event total costs would not exceed £250,000; and (iii) the undertakings given in the letter of intent would be wholly extinguished upon execution of the formal contract.
15. In Spartafield Limited v Penten Group Limited [2016] EWHC 2295 (TCC), the judge concluded that the letter of intent in question allowed each party to walk away until a formal contract was entered into but that issue in itself was in dispute between the parties (see paragraph 93 of the judgment).

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