Avoiding unintentional pitfalls

Disputes over letters of intent are as common as ever but, argue Will Buckby and Andrew Croft of Beale and Company, they can easily be avoided, or at least used with greater care.

KEY POINTS
- The recent case of Merit Process demonstrates that letters of intent continue to cause difficulty for parties
- By their very nature letters of intent do not contain all the detailed terms of the parties’ agreement and provisions required to govern construction works, and therefore they commonly give rise to disputes
- The Merit case and many others demonstrate the pitfalls of using letters of intent
- One can avoid letters of intent altogether, or, more likely, use them with great care
- When using a letter of intent parties should try and create an enforceable agreement which is clear and precise, so as to reduce the risk of dispute

In the recent case of Merit Process Engineering Ltd v Balfour Beatty Engineering Service (HY) Ltd [2012] EWHC 1376 (TCC) it was held that the parties had failed to conclude a binding sub-contract in respect of works undertaken in accordance with a letter of intent. Accordingly, Balfour Beatty failed to enforce a sub-contract which it thought had been agreed.

The case demonstrates that letters of intent continue to cause difficulty for parties involved in the construction industry and it can be added to the list of high profile cases which have been brought before the courts on this subject.

How letters of intent rose to infamy
Letters of intent are a popular tool. Yet judges, practitioners and academics have all made some frank comments about using them. For example, in RTS Flexible Systems Ltd v Molkerei Alois Muller GmbH & Co KG (UK Productions) [2008] EWHC 1087 (TCC) Clarke J stated that ‘this case is another example of the perils of proceeding with work under a letter of intent’.

Further, Judge Coulson QC said in Cunningham v Collett & Farmer [2006] BLR 97: ‘Upon the issue of the Acceptance Certificate the Performance Bond shall become null and void (save in respect of any pending or previously notified claims) …’

What is all the fuss about? The extent to which issues may arise as a result of proceeding under a letter of intent depends upon the drafting and the facts of the case. However, one conclusion that can be drawn is that by their nature letters of intent do not contain all the detailed terms of the parties’ agreement and/or the typical mechanics expected in a standard building contract. This commonly leads to problems.

Additionally, if a letter of intent does not contain all the necessary provisions it will be unenforceable and not a valid contract. This can have significant consequences. For example, in the absence of an enforceable agreement, the client will lose control over the timetable/programme as the contractor will only be required to undertake the works within a ‘reasonable time’. Furthermore, if there is no contract the contractor will be paid on a quantum meruit basis and there is often dispute as to what this entails.

The pitfalls
There is much case law which demonstrates the typical pitfalls in using letters of intent. British Steel Corpn
carried out in excess of the limit. Unsurprisingly, the
that it was entitled to a reasonable amount for work
Mowlem’s entitlement to payment. Mowlem argued
in excess of the £10 million and a dispute arose as to
maximum of £10 million. Mowlem carried out work
limited Mowlem’s entitlement to payment to a
entered into a letter of intent which unequivocally
the parties
Ports Ltd [2004] EWHC 2206 (TCC)
could be enforced.
the JCT form and the adjudication provisions thereof
incorporating the JCT form had been agreed. The letter
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of intent all the terms of a building contract
the court of appeal held that by way of the tender and
contract would be entered into in that form. However,
terms of the JCT form; it simply anticipated that a
was held that the letter of intent had not incorporated
was no contract since there were a sufficient number of
key terms (such as the specifications and the price of
the nodes) which had not agreed. As there was
no contract there could be no breach and Cleveland
Bridge failed to claim damages. British Steel was
entitled to be paid on a quantum meruit basis.

Another apt example is provided in Bryen &
Langley Ltd v Boston [2005] EWCA Civ 973. Bryen
successfully tendered to carry out works for Boston
following which Boston issued a letter of intent to Bryen
stating that the contract would be executed under the
form of JCT 98. Bryen commenced the works but the
JCT 98 was never signed by Boston. When Boston
failed to pay the sums claimed in Bryen’s interim
certificate in full, they referred the claim to adjudication
under the JCT adjudication rules included in JCT 98.
At first instance (see [2004] EWHC 2450 (TCC)) it
was held that the letter of intent had not incorporated
the terms of the JCT form; it simply anticipated that a
contract would be entered into in that form. However,
the court of appeal held that by way of the tender and
the letter of intent all the terms of a building contract
incorporating the JCT form had been agreed. The letter
of intent did therefore create a contract incorporating the
JCT form and the adjudication provisions thereof
could be enforced.

In Mowlem plc (t/a Mowlem Marine) v Stena Line
Ports Ltd [2004] EWHC 2206 (TCC) the parties
entered into a letter of intent which unequivocally
limited Mowlem’s entitlement to payment to a
maximum of £10 million. Mowlem carried out work
in excess of the £10 million and a dispute arose as to
Mowlem’s entitlement to payment. Mowlem argued
that it was entitled to a reasonable amount for work
carried out in excess of the limit. Unsurprisingly, the
court refused to imply such a term and held that it
would not make commercial sense if Mowlem could
avoid the limit on its right to payment by carrying on
with the work and exceeding it. Accordingly, Mowlem’s
entitlement to payment for works carried out under
the letter of intent was £10 million.

The recent cases of Diamond Build Ltd v Clapham
Park Homes Ltd [2008] EWHC 1439 (TCC) and RTS
Flexible Systems Ltd v Molkerei Alois Muller GmbH
& Co KG [2010] UKSC 14 involve similar issues and
reasoning by the courts. In Diamond Build the parties
agreed a letter of intent which contained, amongst other
things, insurance requirements, stated an intention
to enter into contract pursuant to a JCT form and
provided that Diamond Build would be reimbursed
costs until instructed to stop. The works were delayed
and Clapham Park Homes gave an instruction to stop
work. Diamond Build asserted that the JCT form was
the relevant contract, not the letter of intent and that
no entitlement to terminate under the JCT form had
arisen. The court concluded that the letter of intent
gave rise to a simple contract as it contained the key
requirements of a contract: a commencement date, a
completion date and an overall contract sum. On the
facts of the case the court did not follow the Bryen
case and held that the JCT form had not been incorporated;
the parties had made clear that the letter of intent would
dictate their rights and obligations until the contract
was executed and as such the contractor’s attempt to rely
on the JCT form in respect of the employer’s right to
terminate accordingly failed.

In RTS Flexible Systems the parties entered into
a letter of intent which specified the contract sum;
specified the work to be done; identified a programme
for carrying out those works; specified the form of
contract; allowed the employer to terminate the letter
of intent but entitled the contractor to be paid to works
done to date; and had an expiry date. Once the letter
expired RTS continued to perform the services, and
was partially paid for doing so. At first instance Clarke J
(see [2008] EWHC 1087 (TCC)) found that there was
simple contract between RTS and Muller pursuant to
the letter of intent which expired on the expiry date. The
case was ultimately appealed to the Supreme Court, but
this particular issue was not discussed.

Finally, in Merit Process Engineering Ltd the parties
entered into a letter of intent which provided that
if a contract was not concluded, Merit was entitled
to its costs up to a limit of £500,000. The limit was subsequently raised in stages, following which Balfour Beatty sent a sub-contract to Merit, which was not signed. A dispute arose as to the agreed limit on Merit’s costs and Balfour Beatty attempted to enforce an arbitration clause in the subcontract. It was held that no simple contract had been concluded because the parties had failed to reach agreement on the price. Although the difference between the parties was relatively small, it was considered too significant to be overlooked. Balfour Beatty was therefore unable to enforce the arbitration clause.

What is the message from these cases?
The above cases demonstrate the typical pitfalls in using letters of intent. The key messages are perhaps:

- Letters of intent do result in disputes, mainly because the key terms are not agreed and/or the letter does not contain the mechanics/processes included in a typical building contract.
- Nevertheless, the courts are very keen to find a deemed contract between the parties, so as to entitle the contractor/sub-contractor to payment as demonstrated in *Diamond Build* and *RTS*. The courts are highly likely to give the contractor a payment entitlement, unless as *Mowlem* shows, there is a clear and unequivocal limit on the contractor’s fee.
- For a contract to be formed the key terms need to be agreed, as demonstrated in *Merit Process*, *Byren*, *Diamond Build* and *RTS*.
- Where there is no contract, the courts will allow the contractor/sub-contractor to be paid on a quantum meruit basis, and at the same time the contractor/sub-contractor will have no contract governing their conduct. As such, they cannot be in breach.

How to approach letters of intent
Some organisations have an internal policy not to enter into letters of intent due to the perceived risks. There is, after all, no substitute for a formal building contract. However, there are some clear advantages to using letters of intent. For example, they allow the parties to make swift progress with the works prior to conclusion of the building contract. For sub-contractors it allows them to get started pending finalisation of the main agreement. Further, if drafted properly, the letter of intent can allow the client to instruct contractors to deliver discrete pieces of work that bring certainty in respect of cost and time.

If one is going to use letters of intent, HHJ Coulson QC, in *Cunningham v Collet*, said:

‘A letter of intent can be appropriate in circumstances where:

(i) the contract workscope and the price are either agreed or there is a clear mechanism in place for such workscope and price to be agreed;
(ii) the contract terms are … agreed;
(iii) the start and finish dates and the programme are broadly agreed;
(iv) there are good reasons to start work in advance of the finalisation of the contract documents.’

This suggests that a letter of intent should be a ‘mini-contract.’ Indeed the main reason for entering into a letter of intent is to record an agreement which can be relied upon. The criteria for a binding letter of intent are the same as for any binding contract, ie intention to create legal relations, offer and acceptance and consideration. If these are not achieved, a ‘pure’ letter of intent is likely to be entered into; in which case there will be no formal contract and as outlined above, significant issues can arise.

Additionally, it goes without saying that the terms of a letter of intent should be precise and unambiguous so as to clearly demonstrate the intention of the parties and to reduce the scope for dispute. Where possible, the letter of intent should also include the necessary mechanics/processes included in a typical building contract and this could be through the incorporation of a standard form, such as the appropriate JCT 2005.

Conclusion
By their very nature letters of intent can be problematic as they do not fully record the agreement between the parties. Ideally the formal contractual documentation will be agreed before the works commence. However, there may be commercial benefits to having the works commenced before the building contract is finalised and thus to proceed with a letter of intent. If the works are to proceed on this basis, it is preferable to draft the letter of intent as a mini-contract and in doing so it is important that the key terms are agreed.