Spotlight on letters of intent again

In a follow up to a recent article on letters of intent Will Buckby and Andrew Croft of Beale and Company consider a more recent case that underlines the wisdom of their earlier advice to agree final contract terms as early as possible.

In Construction Law ((2012) 23.7 CL pp 20-22) we summarised the risks and issues associated with using letters of intent. Ampleforth Abbey Trust v Turner and Townsend Project Management Ltd [2012] EWHC 2137 (TCC) further underlines the need to tread carefully as regards letters of intent and demonstrates the importance, both to clients, their consultants and contractors, of agreeing final contract terms and entering into a contract as early as possible. It also highlights the risks to project managers of providing quasi-legal advice and the importance of carefully considering the relationship between limits of liability and professional indemnity requirements.

The facts and findings
The dispute concerned a project for the provision of new boarding accommodation at Ampleforth College (the works) in relation to which Turner and Townsend Project Management Ltd (T&T) was appointed as project manager by Ampleforth Abbey Trust (the Trust). There was an urgent need for the works to start on site and therefore the preferred contractor, Kier Regional Ltd (Kier), commenced under a letter of intent issued by the Trust and drafted by T&T in November 2003. As the works progressed further letters of intent were issued, each of which contained caps on Kier’s recoverable costs and an expiry date. Although a draft contract (the contract) was sent to Kier by T&T at the end of February 2004, the terms were not fully agreed at that time. Despite a number of exchanges between T&T and Kier, Kier would not execute the contract until certain issues (in particular, a consultant’s claim for additional fees) were resolved. On 14 September 2004, on T&T’s advice, the Trust issued a final letter of intent which expired on the practical completion date and limited Kier’s recoverable costs at £4,951,365, the intended contract price. The works were delayed and in January 2005 the Trust informed Kier of its intention to deduct liquidated damages based upon the terms of the contract, which remained unexecuted. Kier denied that the Trust had any right to deduct liquidated damages on the basis that the letters of intent did not provide for such. Practical completion of the works...
was achieved on 21 March 2005 and the Trust’s claim ultimately amounted to £750,000. In response, Kier demanded additional payment for the works, alleging that it was due a total of £5.78m and that the cap on recoverable costs in the letters of intent ceased to apply. In February 2006 the Trust and Kier reached settlement at mediation whereby Kier would be paid only up to the cap of £4.95m and would execute the contract but no liquidated damages would be deducted. The contract, amended to reflect the settlement, was executed on 4 April 2008.

The Trust commenced proceedings against T&T alleging that it should have advised the Trust of the limited protection afforded by letters of intent and taken action to procure Kier’s execution of the contract. The Trust maintained that, as Kier would have been liable under the contract to pay liquidated damages for delay, if the contract had been executed it would have obtained a more favourable resolution of its dispute with Kier. The judgment of Judge Keyser QC in the Leeds District Registry of the TCC contains some very interesting comments regarding letters of intent, the duties of a project manager and limits of liability.

The letters of intent issued by T&T in relation to the works provided that the contract would be entered into once certain matters were resolved, but that neither party would be bound by its terms until the contract was executed. The letters of intent did not provide for liquidated damages to be payable in the event of delay, although the contract provided for them to be levied at £50,000 a week.

In RTS Flexible Systems Ltd v Muller [2010] 3 All ER 1 the Supreme Court made clear that a ‘subject to contract’ provision does not necessarily preclude a contract coming into existence. Interestingly, Judge Keyser QC considered that this was analogous to a ‘subject to contract situation’ given that the letter of intent stated that the contract would not be binding until executed and in light of subsequent conduct of the parties, but confirmed that in such circumstances it will be exceptional for an implied contract to arise through conduct. This was not considered to be an exceptional case and an implied contract did not arise. It should be noted that T&T’s initial advice that the works commence under a letter of intent was not considered to be negligent, given the importance of early commencement of the works. The court described the letters of intent as:

‘offers to contract on strictly limited terms and on a short-term basis, coupled with an expression of an intention to enter in due course into a full and final building contract, the terms of which would not however bind the parties until it was executed.’

This suggests that letters of intent do serve a practical purpose in some circumstances and accords with the suggestion in our previous article that when letters of intent are used they should be a ‘mini-contract’. However, the judgment also highlighted that letters of intent should only be used in very limited circumstances. The letters of intent were described as ‘contracts of a skeletal nature’ which:

‘expressly negative the applications 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.’

Similarly a letter of intent will not, as a standard form contract would, reflect the ‘complexities of the projects to which they relate’ or ‘attempt to address the many and varied problems that can arise’ on a construction project. Accordingly, by their very nature proceeding with works under a letter of intent will increase the risk of a dispute arising. The court considered that the fact that the works had been completed under a letter of intent was an ‘unhappy outcome’ and a mark of ‘something having gone wrong’. In a project of this nature the execution of a contract was ‘fundamental’.

The court considered that given the importance of a contract, simply relying on letters of intent was not sufficient and that T&T had therefore failed to exercise reasonable skill and care. Although T&T was not under an absolute obligation to procure execution of a formal contract, T&T had failed to focus on matters which needed to be resolved to ensure a contract was signed and had failed to bring proper pressure to bear on Kier.

It should be noted that this judgment highlights a further risk associated with letters of intent, in that they can serve as a disincentive to parties to concluding the contract. Whilst T&T did highlight the outstanding issues, by continuing to issue letters of intent it did not encourage Kier to execute the contract. The court suggested that T&T could (and
should) have been more proactive and encouraged Kier to execute the contract by informing Kier that no further letters of intent would be issued, identifying an action list and setting a deadline. It is also interesting to note the court’s view as to T&T’s duties in relation to the provision of legal advice. T&T had assembled the contract documents and letters of intent in the mistaken belief that the terms of the contract would apply to the works undertaken pursuant to the letters of intent. Importantly, it was held that T&T could not rely on the fact that it was not a lawyer to make up for its misunderstanding of the law in this regard.

This confirms that consultants involved in procurement should be extremely careful when straying into the provision of ‘legal advice’. Pozzolanic Lytag Ltd v Bryan Hobson Associates [1998] EWHC 285 (TCC) held that if a project manager does not have the expertise to advise in relation to a matter within the scope of its services, it should seek expert advice or advise the client to do so. This judgment confirms that project managers should take note of that guidance when advising on procurement.

The court also considered whether the clause in T&T’s appointment (based on its own standard term of business) limiting its liability to the amount of its fees (which were circa £110,000), was unreasonable and unenforceable under the Unfair Contract Terms Act 1997 (UCTA). Section 11(4)(2) of UCTA provides that when determining whether a limitation of liability in a parties’ standard terms of business is reasonable it should be considered whether that party could have covered himself by insurance. T&T’s appointment required it to maintain PI insurance to a level of £10m. In Moores v Yakeley Associates Ltd v Bryan Hobson Associates Ltd (1998) 62 ConLR 76 a limit of liability of approximately ten times the consultant’s fee and equivalent to the estimated project cost was held to be reasonable and enforceable despite the fact that the consultant had in force PI insurance at twice the level of the limit of liability. However, in this case, Judge Keyser QC held that, although T&T’s limit of liability was ‘plain to read and easy to understand’, it was unreasonable and unenforceable. This decision was made largely on the basis of the disparity between the limit and the level of PI insurance T&T was required to maintain. It was considered that the limit of liability rendered a large part of the PI insurance requirement, which would in some way have been reflected in T&T’s fees, ‘illusory’.

Interestingly, unlike in Moores v Yakeley, the court did not consider the limit of liability in light of T&T’s actual level of PI insurance (which may have been significantly higher than £10 million).

This decision can perhaps be distinguished from Moores v Yakeley in that the latter did not refer to a contractual requirement to maintain insurance and in this case there was not considered to be any justifiable reason for the limit of liability.

The way in which T&T’s appointment was agreed was also significant. The appointment was the third of three between T&T and the Trust and was submitted as an attachment to T&T’s fee proposal. The limit of liability was not included in T&T’s appointments for the two previous projects and T&T did not draw the Trust’s attention to the fact that they were introducing new terms. The Trust had not therefore read the documentation closely and had assumed that the previous two appointments would simply ‘roll over’. The judge accepted the Trust’s submission that it was:

‘wrong that after building up a relationship of trust from the two previous projects … TTPM should seek to introduce this draconian term which was wholly inconsistent with the requirement for substantial professional indemnity insurance without specific notice and any discussion.’

Significance of the ruling

This case offers numerous lessons and provides some interesting points of law. For example it is one of many cases demonstrating the risks of proceeding under a letter of intent and is sure to be widely cited; it underlines that by their very nature letters of intent increase the risk of disputes arising and that they should only be used in limited circumstances. Further, consultants responsible for advising in relation to procurement should take note of the need to be proactive in finalising the contract and should take care when advising on ‘legal’ issues; if in doubt the client should be advised to take professional legal advice.

This judgment will also be of significant interest to construction professionals who regularly rely upon limits of liability in their standard appointments as it demonstrates the importance of considering any such limit of liability in light of the contract as a whole, including any PI insurance requirement, and of taking measures to ensure that the client has been made aware of any such limit. CL