

LETTERS OF INTENT REVIEWED

The purpose of this article is to consider the following:

1. What is a letter of intent;
2. What is their purpose;
3. What is their contractual significance;
4. How is remuneration measured; and
5. What impact does legislation have on them for example:
 - a. Housing Grants, Regeneration and Construction Act;
 - b. Late Payment Commercial Debts (Interest) Act;
6. Finally, some key points in drafting a letter of Intent.

1 What is a Letter of Intent?

To assist in answering this question, Judge Fay in the leading case **Turriff Construction Limited v Regalia Knitting Mills Limited**¹ considered a letter of intent to mean:

'a letter is no more than the expression in writing of a party's present intention to enter into a contract at a future date. Save in exceptional circumstances it can have no binding effect...'

Therefore a letter of intent will have two principle characteristics:

1. It is simply an expression of intention to enter into a contract in the future;
and
2. It will usually have no binding effect.

The implications are obvious to any prospective party who may want to rely on the letter since if not properly drafted they may well do so under the mistaken belief that the letter of intent will have some contractual merit and therefore protection.

2 What is the purpose of a Letter of Intent?

As everyone will appreciate the purpose of a letter of intent is to expedite matters and allow for the situation where the contractor believes he has sufficient security to begin either preparatory work or works under the intended contract.

This gives the Employer/Contractor more time to prepare the formal contract and negotiate the contract terms as the case may be, which would assist both parties to avoid hastily agreeing terms without proper consideration.

It therefore follows that any party drafting or relying on a letter of intent needs to ensure that it has some contractual meaning.

¹ Queens Bench Division (1971) 9 BLR 20

3 What is the contractual significance of a Letter of Intent?

The contractual significance of a letter of intent may be best explained in the examination of the well-known case **British Steel Corporation v Cleveland Bridge and Engineering Limited Company**²

The facts of the case are simple – Cleveland were constructing a bank in Saudi Arabia and were in negotiation with British Steel to supply some steel nodes, on 21 February 1979, Cleveland sent to the following letter of intent to British Steel, which stated:

‘we are pleased to advise you that it is [our] intention to enter into a subcontract with your company, for the supply and delivery of the steel castings which form the roof nodes on this projectwe understand that you are already in possession of a complete set of our node detail drawings and we request that you proceed immediately with the works pending the preparation and issuing to you of the official form of Subcontract’

Firstly, from Judge Fay’s definition the letter certainly sets out an intention to enter into a future contract, but as can sometimes happen no formal contract was ever sent to British Steel. Nevertheless, could this still be one of the exceptional circumstances alluded to by Judge Fay to provide a binding agreement between the parties?

The short answer was that as no contract had come into existence British Steel were potentially looking at the possibility of receiving nothing for the work they had completed.

It was therefore necessary for British Steel to argue a claim in *restitution* and for a payment based on a quantum meruit basis, which being an equitable remedy is only available at the court’s discretion.

R Goff went on to say about letters of intent:

‘There are no hard and fast answer to the question whether a letter of intent will give rise to a binding agreement; everything must depend upon the circumstances of the particular case.’

In essence the parties often want more than a true letter of intent and if the subsequent negotiations fail to resolve a formal contract difficulties may ensue in relation to the interim works and what will be of paramount importance will be whether or not the parties intended to create legal liability.

² Queens Bench Division (1981) 24 BLR 94

R Goff's view was:

'Both parties confidently expected a formal contract to evaluate. In these circumstances, to expiate performance under that anticipated contract, one requested the other to commence the contract work, and the other complied with that request. If thereafter, as anticipated, a contract is entered into, the work done as requested will be treated as having performed under that contract; if contrary to their expectation, no contract was entered in to, then the performance of the work is not referable to any contract the terms of which can be ascertained, and the law simply imposes an obligation on the party who made the request to pay a reasonable sum for such work as has been done pursuant to that request.'

It is important to recognise that in the Cleveland Case, the existence of a contract was particularly important, not necessarily for British Steel but also Cleveland who were counterclaiming against British Steel for late delivery of the steel nodes and the success of this counterclaim was entirely dependant upon finding a contract. As no contract was found, British Steel received payment based upon reasonable remuneration and Cleveland's counterclaim sank without trace.

This would have the same affect on other express provisions such as an arbitration clause³, which would also be lost and this may even go as far as whilst the contractor may have commenced the works (as in the Cleveland Case) unless obligated to do so in the letter he did not need to finish the works.

Executory or "if" contract

It is a matter for analysis but if any contract does come into existence following a letter of intent it may take one of two forms, either it will be:

1. An ordinary executory contract, under which each party assumes reciprocal obligations to the other; or
2. There will be what is sometimes called an "if" contract, i.e. a contract under which A requests B to carry out a certain performance and promises B that, if he does so, he will receive a certain remuneration for his performance. This contract is no more than a standing offer, which if acted upon before it lapses or is lawfully withdrawn, will result in a binding contract.

In the Cleveland case R Goff, found neither type of contract on the basis that when the letter was sent, the parties still needed to agree the material terms of a contract and therefore it could not be an executory one and it was not an "if" contract since negotiations on the price were never concluded.

³ Galliard Homes Limited v J. Jarvis and Sons Plc 1999 and Birse Construction Limited v St David Limited 2000

4 Measure of remuneration

In conclusion in the absence of an express agreement or where the court has refused to imply that the letter has given rise to a binding contract the rights and liabilities of the parties are limited to those contained in the letter.

This can be illustrated by two examples:

In **Monk Construction Limited v Norwich Union**⁴, both parties were bound by the contents of the letter. However, once Monk with approval of Norwich Union went beyond the authorised £100,000 limit, the Court of Appeal held that the terms of the letter of intent no longer applied and Monk were entitled to be paid a reasonable sum for works actually carried out, which in this case was a claim for £4 million.

Similarly in **Serck Controls Limited v Drake and Scull Engineering Limited**⁵ a price and scope of works were agreed, but to expedite the works a letter of intent was agreed stating that Serck will receive 'reasonable remuneration'. No final contract was agreed and the circumstances under which the works had been carried out also changed. It was held that Serck were entitled to receive reasonable remuneration for the work actually done including all delays and costs arising out of the defaults by Drake and Scull without reference to the price originally agreed.

5 Impact of Legislation

a) The Housing Grants, Construction and Regeneration Act 1996

Even if a binding contract exists this does not mean that the letter will be a 'construction contract' within the meaning of the Act, it must still incorporate all the requirements of the Act. For example:

An instruction or authorisation to carry out construction works in compliance with section 104 (1).

If the letter does not comply with the payment or adjudication provisions then the Scheme for Construction Contracts will apply.

b) The Late Payment of Commercial Debts (Interest) Act 1998

From the 1st November 2002 all businesses have a statutory right to claim interest. If the letter fails to deal with interest or provides a remedy which not 'substantial', the Act will impose a right of interest at the current rate based upon the Bank of England base rate plus 8%.

⁴ Court of Appeal (1992) 62 BLR 107

⁵ TCC (2000)

6 Drafting a Letter of Intent

Often the reality is that the parties do not want a 'true' letter of intent, rather they want to create temporary legal obligations before they can agree the formal contract. Consequently the letter of intent will if it is going to be binding on the parties, need to contain all the necessary and essential terms.

In summary a letter of intent should include as a minimum the following as applicable:

- Identify the terms and scope of the works that the contractor will carry out.
- Include a statement of the employer's intention to accept the contractor's offer.
- Include a limitation to the value of works to be undertaken and rights to set off.
- Include a copy of the draft contract (where possible).
- Include a commencement date, duration and instruction to commence the works.
- Include a right to revoke the letter of intent and a longstop date for automatic termination of the contract.
- Statement that the terms of the letter will be superseded by the contract.
- Identify each party's rights if the contract is not concluded.
- Payment terms and Interest.
- Dispute resolution procedures.

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