Letters of Intent - how to tame the beast

Guest Editor **Laughlan Steer** of **Russell-Cooke LLP** laments the all too common approach to letters of intent that is prevalent in the industry. They should be straightforward, but seldom are because best practice is often ignored.

Letters of intent can be tricky beasts. They ought not to be, but judging by the number that come across our desks, the industry often appears to be behind the curve of the best practice.

My most memorable letter was prepared on a Christmas Eve when the parties were understandably in a bit of hurry. That document (a horror show) led to multiple adjudications, Part 7 proceedings and declaratory relief under Part 8, much of which could have been avoided had the underlying documents been properly drafted. So, what should a cast-iron letter of intent contain?

- A clear explanation of the letter's purpose and the parties' intentions
- The duration and specification of the work, including provisions for non-compliance
- Those terms and conditions applying to the work, including any to be incorporated
- Payment terms, including an expenditure cap and the consequences of reaching this
- Termination provisions, including those relating to entry into formal contract
- Dispute resolution provisions, ensuring compliance with the construction act
- Any insurances relevant to the work
- Intellectual property rights pertaining to the work
- Boilerplate clauses (jurisdiction and the like).

How can they go wrong?

A common error is referring to clauses from the formal contract which the parties intend to enter. Absent express and unambiguous incorporation, lazily appended documents or nebulous references outside the letter will not create legally binding obligations. Parties should therefore take care to properly incorporate any provisions they wish to import into the letter of intent.

In one notable case, an employer appended a draft contract to the letter of intent which itself contained a "subject to contract" clause stating that the terms were not binding unless executed by both parties. The contract went unsigned but following the expiry of the letter of intent, the parties were found to have agreed the terms of the appended contract, having waived the subject to contract clause. The parties had, after all, behaved as if they were bound by the contract.

One employer also found recourse against its project manager for failing to advise on the inherent risks of the letter of intent which it had entered into. That letter failed to provide for delay damages, the result of which was the employer seeking to recover the same from the project manager, alleging it failed to exercise reasonable skill and care when administering the project and issuing the letter. The court agreed, finding that the project manager was liable for over 60% of the damages sought by the employer.

Nor is it beneficial to hide behind uncertainty. In a recent example where the letter of intent was not sufficiently clear to have created binding legal relations, consequential losses which would have otherwise been capped under the letter were held to be claimable by the contractor on a quantum meruit basis, thereby resulting in substantially larger liability for the employer.

Expenditure caps are often problematic themselves. I have encountered several irate employers accusing their contractor of a repudiatory breach for departing from site on short notice. However, where a cap has been reached with no formal contract forthcoming (and absent any terms to the contrary) the contractor

is entitled to notify the employer of the same and depart.

In one specific case (the facts of which are depressingly common) the contractor was authorised to carry out works up to the value of £250,000. It then proceeded to undertake further (unauthorised) works to the tune of £250,000. The cap only applied pending the signing of the formal contract and as this never happened, the contractor was not entitled to be paid the additional £250,000.

In a recent Court of Appeal case, a consultant was accused of the defective design of a car park, to the tune of £40 million. The question was whether or not liability under the letter of intent was capped at £610,000, as had previously been discussed in correspondence between the parties. Clause 3 of the letter stated that work was "to be carried out in accordance to… the Terms and Conditions associated that [the parties] are currently working under." Disagreeing with the first instance decision, the Court of Appeal held that the letter was a standing order and had successfully incorporated the cap, despite the consultant not explicitly stating so in its acceptance of the letter of intent.

These caps are fertile ground for dispute – a letter of intent issued to a piling sub-contactor was recently brought before the Technology and Construction Court in this connection. Having undertaken a significant portion of its piling scope pursuant to the letter before entering the formal sub-contract, the sub-contractor sought to rely upon the limitation of liability contained within its standard terms and conditions.

However, the letter was silent on this issue and the terms had not been incorporated thereinto, meaning that it was the sub-contract that governed all of the piling works. The sub-contractor was not therefore able to avail itself of the limitation. Had works began after entering into the sub-contract, there would have been no uncertainty as to liability.

Finally, letters of intent can also be referred to adjudication. In a very recent case, the court was asked to determine whether a decision could be enforced where an adjudicator had made a determination on the form of contract applicable to the works (i.e. whether the letter of intent properly incorporated the terms of the JCT Design and Build sub-contract). While the judge agreed the adjudicator had been properly appointed under the letter, he was wrong to have determined that terms of the JCT Design and Build sub-contract prevailed.

This was because the letter "contemplated only two possibilities. Either it applied by itself and on its own, with the provision for payment and relevant particular terms contained within it[,] or a JCT contract is actually executed and signed with all the particulars filled in." The court found that the adjudicator ought to have valued the contract on a fair and reasonable basis, rather than in accordance with the JCT sub-contract and, crucially, given that this sub-contract had never been entered into, that the adjudicator did not have jurisdiction. The decision was therefore not enforceable.

What is abundantly clear is that anyone seeking to utilise a letter of intent should ensure the document accurately captures the intention of the parties, with exhaustive provision for the rights and obligations thereunder. **CL**