'IT STARTED OUT SO WELL ...' CONSTRUCTION CONTRACTS AND LETTERS OF INTENT

A paper based on a talk given to the Society of Construction Law at a meeting in Derby on 23rd March 2010

James Bowling

December 2010

D116

www.scl.org.uk

‘IT STARTED OUT SO WELL ...’ CONSTRUCTION CONTRACTS AND LETTERS OF INTENT

James Bowling

Parties to building contracts rarely need to be told that there is all the difference in the world between theory and practice. That does not just apply to the carrying out of the works. Often the parties seem bent on starting as they mean to go on. Contract documents are often put together in a manner which is haphazard, with key documents either not being expressly referred to at all (so that their status as contractual documents is, at best, arguable) or alternatively someone taking an ‘all in’ approach, so that everything or almost everything generated by the project is expressly incorporated into the contract (with the almost inevitable result of adding to the complexity of interpreting the contract, a ‘hierarchy of documents’ clause notwithstanding[1]). Either tendency is pregnant with dispute.

But those things are not what this paper is concerned with: it deals with the other, even more extreme tendency often seen on construction projects. I am referring to the decision to do away with a formal contract altogether. That can be a temporary, ‘stopgap’ solution, usually hit upon in a fit of Panglossian optimism that ‘the documents can be sorted out later’ and a perception that getting on with the works is more important than the dry legal documentation, recording how they are to be carried out, what they are to do, and the small matter of how they are to be paid for. Sometimes doing away with a formal written contract can be intended as a permanent solution, because it is thought that the works intended are very simple and straightforward, and there is no need for a contract.

In these circumstances, the parties are usually struck with a nagging, albeit vague sensation that serious undertakings to carry out and pay for construction works ought to be recorded *somehow*, *somewhere*. That vague impulse usually ends up being expressed in a letter of intent. The problem with such documents are often that:

- The phrase ‘letter of intent’ covers a multitude of different things, and it is not a term of art;
- It is not always clear what the document really means until it has been poured over, at great expense, by a phalanx of lawyers;

1 See for example *Fenice Investments Inc v Jerram Falkus Construction Ltd* [2009] EWHC 3272, 128 Con LR 124 (TCC), para 28, in which the judge remarked that, ‘... the impression can sometimes be given that the draftsman has included in the contract every piece of paper in his office that related, no matter how tangentially, to the project in question’.

- Often the lawyers are called upon not to draft the document, but instead to interpret something that is expressed in informal and sometimes ambiguous language;
- Very often, using a letter of intent simply puts off, rather than solves, the problems – such as how risk is to be allocated under the contract, or the precise specification for the works. These problems then tend to resurface later, when very large amounts of time and money can depend on whose view is right. Given the then higher stakes, a full-blown entrenched dispute results.

Understandably therefore, judges have sometimes been scathing about the use of letters of intent as a solution to how to start works *in lieu* of formal contract documents being drawn up. For example in *Cunningham v Collett & Farmer* Judge Coulson said:

> '... letters of intent are used unthinkingly ... they can create many more problems than they solve. ... once they have been sent, and the contractor has started work pursuant to that letter of intent, all those involved, including the professional team, can easily take their eye off the ball and forget about the importance of ensuring that the full contract documents are signed as quickly as possible. Everybody is then so busy dealing with the day-to-day problems ... that the tasking of signing off an often complicated set of contract documents is relegated to an item of secondary importance. Then, very often, something goes wrong on site ... the result is confusion and acrimony.'

And, echoing the point I make above, in the following paragraph:

> '... letters of intent are used too often in the construction industry as a way of avoiding, or at least putting off, potentially difficult questions as to the final make-up of the contract ... sometimes, they are issued in the hope that, once the work is underway, potentially difficult contract issues will somehow resolve themselves. They are plainly not appropriate in such circumstances.'[2]

There will be few construction litigators who will not recognise the truth of these observations. The purpose of this paper therefore is to examine three things:

1. How letters of intent can and should be classified;
2. What the different types of letters of intent mean, in a legal sense, both in terms of regulating rights and responsibilities, and also for things like adjudication; and
3. To review how these considerations were treated in the recent House of Lords case on letters of intent.[3]

---

2 *Cunningham v Collett & Farmer* [2006] EWHC 1771, 113 Con LR 142 (TCC), paras 88 and 89.

3 *RTS Flexible Systems Ltd v Molkerei Alois Müller GmbH & Company KG (UK Production)* [2010] UKSC 14, [2010] 1 WLR 753, [2010] 3 All ER 1, [2010] BLR 337, (2010) 129 Con LR 1.

The starting point: 'There's bound to be a contract in some form'?

There is a tendency to assume that when the works have been executed (particularly fully executed) and there is a letter of intent in place, then the parties' relations are governed by some kind of contract; that the court will strive for that result, and will find implied terms arising by conduct to fill in any gaps. All that remains therefore is to construe the behaviour of the parties against the letter of intent and fashion a contract out of that material. *Percy Trentham v Archital Luxfer* is often cited as authority for this approach to construing letters of intent, in particular the observations of Steyn LJ:

> 'The fact that the transaction was performed on both sides will often make it unrealistic to argue that there was no intention to enter into legal relations. It will often make it difficult to submit that the contract is void for vagueness or uncertainty. Specifically, the fact that the transaction is executed makes it easier to imply a term resolving any uncertainty, or, alternatively, it may make it possible to treat a matter not finalised in negotiations as inessential. In this case fully executed transactions are under consideration. Clearly, similar considerations may sometimes be relevant in partly executed transactions.'[4]

However, if *Percy Trentham is* authority for such an approach (which is debatable at best, in my view) then Steyn LJ's *obiter dicta* is something of a high water mark. In *Galliard Homes v Jarvis* for example, the Court of Appeal stated very clearly that just because work had been done and money had been paid did not mean that there 'must' be a contract.[5] That approach, which neither assumes, nor rules out, a contract on some terms short of a full blown standard form (perhaps in the form of a letter of intent) but which rather places emphasis on all the facts is surely the right approach. It also now has the endorsement of the Supreme Court. In the recent decision of *RTS Flexible Systems v Molkerei Alois Muller* Lord Clarke said this:

> '... in a case where a contract is being negotiated subject to contract and work begins before the formal contract is executed, it cannot be said that there will always *or even usually* be a contract on the terms that were agreed subject to contract. *That would be too simplistic and dogmatic an approach.* The court should not impose binding contracts ... All will depend upon the circumstances.'[6] [*emphasis added*]

If it's not always a contract, what is it, and how do we find out?

The starting point when construing letters of intent was described in these terms by Judge LLoyd QC in *ERDC v Brunei University*:

> 'Letters of intent come in all sorts of forms. Some are merely expressions of hope; others are firmer but make it clear that no legal

4 *G Percy Trentham Ltd v Archital Luxfer Ltd* [1993] 1 Lloyd's Rep 25, 63 BLR 44 (CA), para 27.
5 *Jarvis Interiors Ltd v Galliard Homes Ltd* [2000] BLR 33, 71 Con LR 219 (CA).
6 *RTS Flexible Systems v Molkerei*: note 3, para 47.

> consequences ensue; others presage a contract and may be tantamount to an agreement 'subject to contract'; others are contracts falling short of the full-blown contract that is contemplated; others are in reality that contract in all but name. There can therefore be no prior assumptions, such as looking to see if words such as letter of intent have or have not been used. The phrase 'letter of intent' is not a term of art. Its meaning and effect depend on the circumstances of each case.'[7]

Faced with that list, one is tempted to call to mind William Goldman's famous aphorism about Hollywood: 'nobody knows anything'.[8] But such defeatism is not helpful to parties, and no one likes (or instructs) a lawyer who says, 'the law is not clear, and I cannot advise you'. So some sort of attempt needs to be made at establishing some broad categories that letters of intent might fall into. These are my suggestions. They are descriptive, not prescriptive. Nor are they rigid categorisations; some letters of intent may start life in one category, but end in another, as the parties vary the letter of intent, either expressly or by conduct. There may be other categories (or better descriptions for my categories) but we have to start somewhere:

1. First, old fashioned 'heads of terms' or 'letters of comfort';
2. 'Restitutionary' letters of intent;
3. 'Contractual' letters of intent (or 'mini contracts');
4. 'The Trojan horse' (by which I mean letters of intent which in fact are nothing of the kind, but instead impose a full-blown set of contractual terms, often including a standard form, onto the parties' relationship).

Heads of terms / letters of comfort

These are perhaps the form of letter of intent seen least in construction disputes. From a lawyer's perspective that is a pity, since they are often the easiest to spot, and the form of letter of intent that most obviously does not give rise to any binding obligations.

Heads of terms are obviously just that. They are usually in essence no more than a negotiating document-cum-*aide memoire*, setting out broad principles of what everyone wants the contract to ultimately include: a glorified shopping list. They are thus usually too vague to be a contract. In addition, the circumstances in which they are produced often rebuts any intention to enter into legal relations. They may well be produced during negotiations which are subject to contract, but even where that is not so, the resulting document is often obviously not intended to be enforceable as a matter of law.

I have included letters of comfort under this heading although they are a slightly different beast. Their effect and language is usually very similar. They create no rights for the same reason as heads of terms do not. They are

7 *ERDC Group Ltd v Brunel University* [2006] EWHC 687, [2006] BLR 255, 109 Con LR 114 (TCC), para 27.

8 William Goldman, *Adventures in the Screen Trade* (Abacus 1996).

usually couched in terms of vague statements of goodwill, or a statement of current policy, without any binding obligation to maintain that policy. They are not binding because the language is too vague to create legal relations.

There is nothing objectionable about this form of letter of intent. These documents are deliberately informal, and are not intended to take the place of contracts. That is why they are rarely seen in a construction context, which tends to use letters of intent *instead* of contracts rather than (as in the case of heads of terms) *precursors* to contracts. Heads of terms / letters of comfort (provided that they are properly drafted) are usually readily identifiable as steps on the way to a contract.

The speech of Lloyd LJ in *Pagnan SpA v Feed Products* provides a very useful set of guiding principles here:

1. When deciding whether the parties have entered into a contract, the first task is to look at the whole of the correspondence.
2. Even if all the terms have been agreed in that correspondence, there is still not necessarily a contract if (viewed objectively) the parties do not *intend* a contract to come into force. The ordinary subject to contract situation is one example of this.
3. An objective view of the behaviour of the parties may indicate that although the parties have agreed a raft of terms which, taken together, are sufficiently certain and complete as to give rise to a binding contract, there will still be no agreement if their communications indicate that they consider one, un-agreed clause so important that nothing is binding until that is settled.
4. The parties may of course intend the opposite: that some terms which are agreed will give rise to some form of binding agreement even though other terms have been left over to be agreed later (for example, 'lock out' agreements are an extreme and obvious form of this).[9]

Even letters of comfort can however be subject to misinterpretation. See for example *Kleinwort Benson v Malaysia Mining* where the Court of Appeal held that a letter of comfort addressed by a parent company to the claimant stating that it was '... our policy to ensure that the business of [the subsidiary] is at all times in a position to meet its liabilities' to the claimant did not give rise to a binding obligation to maintain that policy.[10]

Restitutionary letters of intent

For the reasons I go on to develop below, it might be argued that this is the letter of intent in its proper form, and that parties would be well advised to restrict themselves to signing letters of intent limited to the terms set out below.

9 *Pagnan SpA v Feed Products Ltd* [1987] 2 Lloyds Rep 601**,** para 619.

10 *Kleinwort Benson Ltd v Malaysia Mining Corporation Bhd* [1989] 1 WLR 379, [1989] 1 All ER 785, [1989] 1 Lloyd's Rep 556 (CA).

In the absence of a contract for building work, the law grants a reasonable remuneration for work carried out: a *quantum meruit.* In order for a contractor to obtain a right to a *quantum meruit*, he must show that:

1. The work that he has done was requested or freely accepted (that is, the employer stood by whilst he was carrying it out, knowing that the contractor expected to be paid for it, and thereby acquiesced in it);
2. The work was not 'bestowed officiously' – which amounts to very much the same thing as it being done only as the result of it being requested / freely accepted;
3. The recipient must be 'incontrovertibly benefited' by the work which has been done (although a request for the carrying out of the work will arguably debar any suggestion that the recipient has not benefited in this way).[11]

The purpose then of a straightforward, almost classical letter of intent is not to form a mini, or prototype, contract that the parties can build on. It is not intended to give rise to any contract at all. On the contrary, applying Lloyd LJ's guidelines in *Pagnan v Feed Products*, the parties *do not* intend to be bound because they have not agreed a contract.[12]

Instead, a restitutionary letter of intent is intended simply to record the request for the works to be carried out in the absence of a contract, and record their free acceptance for the purposes of the law of restitution. It is essentially a piece of evidence, therefore, the existence of which gives the contractor the knowledge that he can carry out the work without the employer being able to say that the work he has done in the absence of a contract was at his risk. As such, the letter of intent can and should describe the relevant arrangements very briefly:

- The scope of the works to be carried out in the absence of a contract should be recorded briefly, so as to make it clear what work is being 'freely accepted' / requested.
- Very often the letter of intent will contain a cap on the value of the works that can be carried out under its terms. Again, this is a simple and straightforward part of the mechanism. It means that unless the cap is lifted, the contractor does not have the benefit of written evidence that his work has and will be freely accepted / requested.

Using a simple, obviously non-contractual letter of intent has other benefits. The less formal the documentation, the less likely it is that the parties will be lulled into thinking that it 'will do' for an extended period of time, or even that it can and will replace the contract, in the way that letters of intent amounting to mini contracts do.

11 See for example Goff & Jones, *The Law of Restitution* (7th edition Sweet & Maxwell, London 2006), para 26-010 et seq.

12 *Pagnan v Feed Products*: note 9.

Both sides are aware that the obligations under such a document extend only to the payment of a reasonable amount for the work that the contractor chooses to do. He can (without liability) cease work under it at any stage. The availability of only the limited remedies set out in such a simple letter of intent will also tend to concentrate the mind. It will compel the parties to get on with formalising the contract.

Undoubtedly these forms of letter of intent do exist and are used. It is probably no coincidence however that such incredibly simple documents are the subject of reported cases relatively infrequently. I suspect this is because there are fewer things to go wrong (and when they do, the disputes are purely factual and capable of being resolved relatively quickly and simply).

I have suggested that parties should confine themselves to such restitutionary letters of intent, and not succumb to the natural urge to complicate matters and provide for foreseeable circumstances where they might want to allocate risk. Is that realistic? Does the restitutionary letter of intent give both parties sufficient protection?

Certainly there are pitfalls for both sides in commencing work without a contract. Although not a case involving a letter of intent, the outcome in *Hescorp Italia v Morrison Construction* is instructive. Morrison issued an invitation to tender for the design and erection of structural steel works. Hescorp submitted a qualified quotation. In that quote, they sought to vary the date for completion of the subcontract works and sought a reduction in the LADs. The subcontract documents went backwards and forwards. Neither side would withdraw their requirements. The subcontract works commenced and were completed without a contract ever being agreed.

Morrison subsequently brought a claim for delay. The judge found that no contract had been entered into. As a result, Morrison were not entitled to damages for late completion. Because there was no contract, there was no obligation on Hescorp to complete the works, let alone complete them by any particular time. But similarly, Hescorp could not recover a price in line with their commercial expectations. They were held entitled to reasonable remuneration, on a *quantum meruit* basis only.[13]

Similarly, in *ERDC Group v Brunel University* the following occurred. Letters of intent were issued based upon a JCT form of contract. They were expressly stated to be time-limited. Works were commenced under the terms of those letters. However, the letters expired without a formal contract being entered into, contrary to the parties' expectations when they signed them. By that time, ERDC was not prepared to sign the contract. It claimed that its works going forward were to be valued on a *quantum meruit* basis. The parties then fell into dispute over the value of the works, and the University alleged that there were defects.

13 *Hescorp Italia Spa v Morrison Construction Ltd* 75 Con LR 51, (2000) 16 Const LJ 413 (TCC).

The judge held that there was no contract and therefore there could be no formal counterclaim for defects. However, the works carried out in the absence of a contract under the letters of intent had to comply with statutory implied standards of quality (but no greater standard of workmanship could be imposed in the absence of a contract). ERDC for their part could not recover more than the tender rates which were applicable to the works under the letters of intent.[14]

There are of course other problems for employers with using a simple restitutionary letter of intent:

- There is no completion date – and so no right to recover delay damages, such as LADs;
- Indeed, the contractor has no obligation to complete at all – just a right to be paid for the work he chooses to do;
- The contractor can therefore probably 'pull' labour without liability for delay, disruption to other trades etc;
- There is no right of adjudication, because there is no construction contract within the meaning of the Construction Act[15] (indeed, no contract at all).

Despite these inherent problems, in some ways this is the best form of letter of intent. This is because it is so simple, it admits of relatively few disputes (save for the normal kind which happen on a building project, for example whether the work was within scope, or whether it was defective). The principle criticism that can be levelled against them is that they do not afford either side sufficient certainty or protection. But that is not a criticism of a restitutionary letter of intent; it is a criticism of the fact that the parties have chosen to commence works before agreeing a contract that will govern their respective performance obligations. For its part, a restitutionary letter of intent does exactly what you ask of it. It provides evidential confirmation that a reasonable sum will be paid for the works performed – as well as providing a constant reminder that nothing formal is in place. Overall, that is a better situation to be in than the one which often arises under 'contractual' letters of intent.

'Contractual' letters of intent – 'miniature contracts'

These are more complex documents. They will still be styled 'letter of intent' but they will typically contain:

- Specific reference to project documents, site minutes and drawings in an attempt to define the scope of the works (often by reference to whatever documents are available at the time, whether finalised or not) together with some kind of reference as to how further revisions will be issued at some future point.
- Often, there will be reference to a standard form 'to be entered into' or 'to be formalised.'

14 *ERDC Group v Brunel University*: note 7.
15 Housing Grants, Construction and Regeneration Act 1996, section 104.

- The obligation to pay a reasonable sum for the works directed under the letter of intent will be retained, but it will be coupled with some payment terms, specifying (for example) the need for weekly or monthly payment applications, followed by certification provisions.
- Very often the letter will contain a commitment on the part of the employer to pay demobilisation costs if the project does not proceed, whilst a cap on permitted expenditure is imposed (as with a restitutionary letter of intent).
- Often there will be an attempt to make the letter of intent's payment terms compliant with the requirements of the Construction Act[16] 'just in case'.

As a result of these additional complexities, contractual letters of intent are more dangerous and cause more disputes. One reason for this is that despite their increased complexity, they are often informally drafted by the people on site (whilst the lawyers draw up the project documents). As a result, they often contain latent ambiguities that only surface later. The wording tends to mean different things to different people. They often bring to mind John Locke's famous observation:

> 'Many a man who was pretty well satisfied of the meaning of a text of scripture or clause in the code, at first reading, has, by consulting commentators, quite lost the sense of it, and by those elucidations given rise or increase to his doubts and drawn obscurities upon the place.'[17]

Either that or, in the words of the Humpty Dumpty, the draftsman takes the view that the letter of intent means what he intends it to mean, no more and no less: and why not, in the absence of any authority on the wording used? The standard forms have their critics, but to the extent that they are ambiguous and difficult to follow, they are at least a known quantity, with a body of case law as to what they mean, and they are put together by professional committees. Indeed, the return to individually drafted bespoke short form construction contracts in the form of contractual letters of intent is something of a retrograde step. Standard forms developed as a direct response to the problem of drafting from scratch a set of contract terms regulating complex and highly technical construction projects which forced parties (and often an extended professional team) to work together in close proximity for months or years on end, often with a design that was evolving as the project progressed, and in environmental conditions (such as ground and weather) which were hard to predict, but nevertheless where the parties might want a clear allocation of risk.

Not only are contractual letters of intent a retrograde step in that sense alone. Another problem is that although these documents are often drafted to be project specific, drafts from previous projects – whether suitable for adaptation or not – are often used as the basis for the contractual letter of

16 Housing Grants, Construction and regeneration Act 1996, sections 109-113.

17 John Locke, *An Essay concerning Human Understanding* (Oxford World Classics, OUP, 2008) Book III, Chapter IX, Of the Imperfection of Words.

intent. As a result there is often something of a ratchet effect. However complex the existing draft is at the start, the draftsman will see ways in which to improve it for this project. In doing so, he will invariably increase its complexity, and therefore increase the potential for it to become the subject of dispute. The fact that the document is inevitably needed in a hurry does not help either.

As a result, very often contractual letters of intent are sufficiently certain, and exhibit a sufficient intention to be presently bound that they can be considered contracts in their own right. They nevertheless often fall a long way short of being a clear and complete statement of the parties' rights. They are therefore the form of letter of intent which is most often seen before the courts.

To a great extent, the criticisms set out in the cases that I referred to at the outset are directed towards this form of letter of intent. They have a habit of lulling parties into a false sense of security: the belief that even if a formal contract is not ultimately put in place, nevertheless the letter of intent gives them a sufficient degree of commercial protection. Very often that is not the case, and the letter of intent is either vague on the crucial issues or, as I go on to set out below, it is altogether so complex that it turns out to be something far more binding and comprehensive than the parties ever thought it would. That brings me neatly on to the fourth and final category: the 'Trojan horse'.

The 'Trojan horse'

This is perhaps the most pernicious form of letter of intent. In truth, it is not a letter of intent at all. It is in essence a step on from, or an extreme form of, the contractual letter of intent. It occurs where the draftsman has made the document so sufficiently complex and sophisticated that he has in effect caused the parties to enter into a full-blown construction contract whether they realised it or not.

A good example of the 'Trojan horse' is *Harvey Shopfitters v ADI*.[18] The facts were as follows. The letter of intent referred to an intention to enter into an IFC84 standard form.[19] The reference was curious. It stated that if the IFC84 'failed to proceed and failed to be formalised' then the contractor would be paid on a *quantum meruit* basis rather than tender prices. Works were carried out under that letter of intent. Applications for payment were made under its terms, referring as they did to the IFC84 and its payment provisions, which the contractor therefore adhered to. The contract administrator issued certificates as if the IFC84 was already in place, because the intention was presumably to 'proceed with' and 'formalise' the IFC84. However, the IFC84 was not in the event ever signed – although it was common ground that there was nothing else left to agree. The judge at first instance held that in these circumstances the parties had not, in truth, entered into a letter of intent at all. He construed the letter of intent as incorporating the IFC84, together with the other terms as agreed between the parties, and therefore a full-blown contract on the IFC84

18 *Harvey Shopfitters Ltd v ADI Ltd* [2003] EWCA 1757, [2004] 2 All ER 982, 91 Con LR 71, (2004) 20 Const LJ 291.

19 Intermediate Form of Building Contract, 1984, Joint Contracts Tribunal.

terms was in force even though not signed, and the parties' rights were governed accordingly.

The contractor appealed against the ruling. The Court of Appeal upheld the judge's construction of the contract. It also upheld the judge's alternative finding that the conduct of the parties was such as to give rise to an estoppel by convention that the IFC84 was in place. The parties adhered to the IFC84 terms (in line with their intentions as set out in the letter of intent) in submitting applications for payment in accordance with its terms and the contract administrator issued certificates in response. These were sufficient communications 'across the line', and all of them were conducted on the common assumption that IFC84 governed the position. The Court of Appeal was of the view that in light of these things, it would be inequitable to allow the contractor to go back now and claim a *quantum meruit* under the terms of the letter of intent – because if he had said this was what he wanted at the time, the employer would have insisted on the document being signed.

A similar outcome to the problem of an overly sophisticated letter of intent was seen in *Bryen & Langley v Boston*.[20] Again, the letter of intent in use here made specific reference to the fact that the contract would be on the basis of a JCT98 standard form.[21] Applications for payment and certificates were issued accordingly, on the premise that a formal JCT contract would be signed in due course. Although it was not, Judge Kirkham was of the view that nevertheless, the agreement to carry out the works on the terms of the letter of intent which expressly referred to the JCT form was sufficient to mean that the parties were to be taken to be bound by that JCT contract in valuing the works.

As I said at the outset of this section, the 'Trojan horse' cases are in one sense not a separate category in themselves. Rather they are an extreme form of the contractual letters of intent, where out of an abundance of caution, and in an attempt to provide as much certainty as possible, the draftsman included specific reference to the contract to be entered into. In both of the cases discussed above the effect of doing this was to sign the parties up to that contract. That may well be the objective construction of the words used, but the result might well have come as surprise to a lay observer, as well as the parties themselves. Presumably they did not think that they were signing up to a full-blown standard form contract, to be entered into subsequently and implicitly by conduct, so that as they agreed the terms of the standard form one by one, and began to follow the standard form's requirements for payment, their letter of intent was gradually falling away, being stealthily replaced by a binding and comprehensive standard form.

Adjudication

Adjudication has outgrown its roots. What Parliament clearly intended was merely to provide an interim dispute resolution mechanism for payment problems in employer-main contractor and main contractor-subcontractor

20 *Bryen & Langley Ltd v Boston* [2005] EWCA 973, [2005] BLR 508.

21 Standard Form of Building Contract with Contractor's Design, 1998 edition, Joint Contracts Tribunal.

situations. But it is now used, in the vast majority of cases, as a way of finally determining a wide range of disputes, including high value, complex final accounts. As outlined above, projects governed by letters of intent are pregnant with such disputes. But are letters of intent construction contracts for the purposes of the Construction Act?[22]

This is a good question for a lawyer. The answer is: it depends. Certainly some letters of intent amount to construction contracts. The more sophisticated the letter of intent, and thus the further it is towards the contractual end of the spectrum, the more likely it will be to fulfil the criteria for being a construction contract.

So for example in *Harris Calnan Construction v Ridgewood* the facts were as follows.[23] The parties entered a sophisticated and highly developed letter of intent. Judge Coulson thought that the question of whether there was a 'construction contract' was probably referred to, and decided by the adjudicator with the parties' consent. He also decided though that even if he was wrong about that, the form of the letter of intent that the parties had entered into was a sufficiently complete agreement as to give rise to a statutory right to adjudicate.[24] He dismissed the argument that the cases showed that letters of intent were not construction contracts, holding that in each case turned on its own facts.

Similarly in *Diamond Build v Clapham Park Homes*, Judge Akenhead was in no doubt that the letter of intent before him was a sufficiently clear, albeit simple, form of contract sufficient to amount to a construction contract under the Construction Act.[25]

But predictability, the cases do not all go one way. In *Hart Investments v Fidler* there was a very basic letter of intent, under which the claimant had purported to refer a dispute to adjudication.[26] The adjudicator had purported to decide the dispute in favour of the claimant. On enforcement of that decision, the defendant argued that the letter of intent did not amount to a construction contract because there was nothing more than an agreement that they would comply with instructions to carry out work as and when they were given, and receive a reasonable remuneration for doing so. To meet that argument, the claimant argued that such a simple agreement nevertheless provided a written framework sufficient to regulate the parties' positions and to amount therefore to a construction contract under the Act.

Judge Coulson dismissed the claim to enforce the adjudicator's decision. He held that if such a simple letter of intent was a contract, it was of the 'loosest and vaguest kind'. There was no agreement as to time, the agreement to price

22 Housing Grants, Construction and Regeneration Act 1996, section 104.
23 *Harris Calnan Construction Company Ltd v Ridgewood (Kensington) Ltd* [2007] EWHC 2738 (TCC), [2008] BLR 132 (TCC).
24 *Harris Calnan v Ridgewood*: note 23, para 11.
25 *Diamond Build Ltd v Clapham Park Homes Ltd* [2008] EWHC 1439, 119 Con LR 32 (TCC).
26 *Hart Investments v Fidler* [2006] EWHC 2857, [2007] BLR 30, 109 Con LR 67, [2007] TCLR 1 (TCC).

was limited and there was uncertainty as to the identity of the parties. There was no sufficient clarity of terms therefore, and no sufficient contractual certainty. There was no construction contract, and therefore the adjudicator lacked jurisdiction.

In particular, the judge made the following observations, which are pertinent to any claim that a very short form letter of intent is nevertheless sufficient to amount to a construction contract:

> 'The first question is whether the three numbered paragraphs constitute a binding/enforceable contract at all. On analysis, it is not easy to say that they do. Essentially Hart are saying to Larchpark that if they, Hart, ask Larchpark to carry out work, Larchpark would be paid their reasonable costs for so doing.
>
> ... the sort of clarity of terms envisaged by section 107(2)(c)[27] and the Court of Appeal in *RJT*[28] is wholly absent. It is trite law that in order to have a building contract you usually need agreement as to parties, workscope, price and time.
>
> However, the biggest difficulty comes with a consideration of the contract workscope. The workscope is ... work which [according to the letter of intent] will, or might be, the subject of orders in the future, whether written or oral. It is based on subsequent orders, instructions and the like, which may, or may, not have been reduced to writing. If the contract document does not even begin to define the contract workscope, it seems to me impossible to say that all the terms, or even the material terms, are set out in writing.'[29]

It might be said that my recommendations that parties should stick to short form letters of intent, where less is more, might be undermined by the decision in *Hart Investments v Fidler*, which holds that to the extent that such letters of intent amount to contracts, they are not contracts under which the parties can adjudicate their disputes. After all, is adjudication not the great success story of the last ten years? Do parties not want to make sure that they can avail themselves of this remedy whenever possible? Maybe so. But to return to the theme of what I said earlier, the unavailability of such remedies is not a criticism of a restitutionary letter of intent. It is a criticism of the decision of the parties to start works without entering into a contract. If the choice is between, on one hand, making it clear that nothing is agreed and no one is bound, and that everyone is proceeding with the project at risk unless and until a full set of contact documents is agreed; and on the other hand, proceeding under a document which is something more than a simple document agreeing to pay a reasonable sum, but less than a full contract (although if there is a dispute, no one is sure *where* between those two points it lies unless and until lawyers are involved) then my vote is that the simplest solution is the best one.

---

27 Of the Housing Grants, Construction and Regeneration Act 1996.

28 RJT *Consulting Engineers Ltd v DM Engineering (Northern Ireland) Ltd*, [2002] EWCA Civ 270, [2002] 1 WLR 2344, [2002] BLR 217, (2002) 18 Const LJ 425, 83 Con LR 99, [2002] TCLR 21.

29 *Hart Investments v Fidler*: note 26, paras 59, 60 and 61.

That is particularly so if it encourages the parties to get on with agreeing the contract.

RTS Flexible Systems v Molkerei[30]

The Supreme Court handed down their judgment in this case in March 2010. It is tempting to say that any recent case on a particular field which reaches the Supreme Court is now the leading case in that area. But I am not sure that this decision adds much to the law in relation to letters of intent. If anything, it tends to demonstrate that where a letter of intent is used, everything turns on the facts of the case.

Summarising briefly, the relevant facts were as follows. Muller and RTS entered into negotiations in relation to supply and installation. So that work could begin during the negotiations, a letter of intent was entered into. It expired on 27th May 2005. However, work continued after this date. The letter of intent provided for the agreed contract price. It was not limited to the price of the works carried out during the period for which the letter of intent was operative. It was envisaged by the letter of intent that the full contract terms would be based on Muller's amended version of the MF/1 standard form,[31] with the contract to be signed within four weeks of the date of the letter of intent. A final draft contract was provided by 5th July 2005. By this stage all the essential terms had been agreed. However, the parties had expressly provided that the contract would not become binding until signature and exchange. There were some further variations to the contract in August 2005.

On these facts, Muller argued that there was no binding contract between the parties because no contract had been signed or exchanged. The parties had expressly agreed that the contract documentation, although agreed, was not binding until signed (the second situation mentioned by Lloyd LJ in *Pagnan v Feed Products*[32]).

The issues for the Supreme Court were therefore twofold. First, whether, after the expiry of the letter of intent, Muller and RTS had entered into a contract. If so, its terms, and in particular whether the contract was subject to some or all of Muller's amended MF/1 terms.

The Supreme Court held as follows: all the essential terms had been agreed by 5th July 2005. The August variations were agreed without stating that they were subject to contract. The conduct of the parties indicated therefore that they had agreed to waive the subject to contract clause in the contract. The actions and communications of the parties indicated that they had agreed to be bound by the terms of the contract without the necessity of a formal written contract. The parties were therefore bound by Muller's amended MF/1 terms as negotiated and agreed on 5th July and varied in August 2005.

---

30 *RTS Flexible Systems v Molkerei*: note 3.

31 Model Form of General Conditions of Contract (revision 4), December 2000, Institution of Mechanical Engineers.

32 *Pagnan v Feed Products*: note 9.

What then does the decision of the Supreme Court in *RTS Flexible Systems v Molkerei* tell us?[33] Those looking for broad statements of principle, or for the Supreme Court to synthesise the cases and comprehensively restate the law in this area will be disappointed. The *ratio* of the decision is rooted deep in the facts of the case. It is very difficult to extract any clear or obvious new principles from it. The decision is, in my view, illustrative rather than didactic. It demonstrates that the decision to use letters of intent as a stopgap measure are simply putting off, rather than solving, the fundamental problem of what their contractual relationship is going to look like. No doubt some might have thought that by specifically providing that the contract would not become binding unless and until signed and exchanged, the parties would continue to operate under the letter of intent. The Supreme Court thought otherwise. The problem, of course, was that once works started and costs were incurred, the project developed a dynamic of its own. It became impossible for the parties to extricate themselves from the negotiations and agreement of the MF/1 form – despite express written provisos to the contrary.

Conclusions

In summary, my views are pretty straightforward, even traditional. Letters of intent have a valid role. But their limitations must be recognised, although all too often they are not. They are a necessary evil which should only be resorted to when it is absolutely essential to commence works prior to finalising the contract documents. They are not a replacement for a contract, although they are often treated as such. Whatever their form, they have significant drawbacks. If they are sufficiently simple and clear, they offer little protection for either party. If more complex, they are more ambiguous, and thus more open to differing interpretations. They rarely offer certainty as to scope, price or timescale; and if they do, they spectre of the 'Trojan horse' usually looms.

With these rather Eeyore-ish pronouncements out of the way, if you really must use a letter of intent, this is my 'good practice checklist'. Since barristers usually deal with litigation (the pathology of the law) and are rarely called on to advise before agreements are entered into, they are points which I never usually get to make when they might be of some use, and when highlighting them after the event might be thought unpolitic. So this may be my only chance to make them:

1. Why are the contract documents not finalised? The further they are from being ready, either because they have not been put together at all or (worse) because there is some sticking point in the negotiations, then the more cautious the parties should be to deploy a letter of intent. What's bad on the ground gets worse in the air.

2. Are there good reasons to start work in advance of finalisation of the contract documents? Often-times, there are not. If works and trades need to be phased, the projects that go well often have their documents prepared in one fairly unified process, so as to have

33 *RTS Flexible Systems v Molkerei*: note 3.

some kind of 'line of sight' through the various works packages. If one of these has been left out, or cannot be agreed, that is usually a sign of trouble to come. An obstreperous subcontractor is not going to become more biddable once he is on the job, under a letter of intent that gives him a reasonable return on whatever work he chooses to do, and under which he can walk off site without liability at any given moment. Quite the reverse.

3. Are (a) contract works (b) scope and (c) price agreed? These are the three main things that need to be sorted out. If they are not common ground (at least in principle) when the letter of intent is signed, the very best that one can say is that the contractor / subcontractor operating under the letter of intent has a tremendous commercial lever in negotiating terms subsequently.

4. If not, is there a clear mechanism in place for the key elements (such as the works, scope, price, start and finish dates and so on) to be agreed, and is it likely that they will be? Be realistic; this is easier said than done.

5. If a letter of intent must be used, resist the temptation to over complicate it. It is likely to end badly. Go for something simple, such as a restitutionary letter of intent. Everyone knows where they stand under that; and it gives an impetus to agreeing the formal contract.

James Bowling is a barrister practising from 4 Pump Court, Temple, London.

'The object of the Society
is to promote the study and understanding of
construction law amongst all those involved
in the construction industry'

MEMBERSHIP/ADMINISTRATION ENQUIRIES

Jill Ward
The Cottage, Bullfurlong Lane
Burbage, Leics LE10 2HQ
tel: 01455 233253
e-mail: admin@scl.org.uk

website: www.scl.org.uk