

## LETTERS OF INTENT

**J McMullan**

IIR Conference, Construction Law, Sydney, 12 December 1991

### 1. INTRODUCTION

This paper examines some issues arising out of the use of letters of intent in construction contracts.

Parties to construction contracts often (perhaps usually) resort to letters of intent for a number of reasons, including:

- anticipated delay in the preparation/agreement of the proposed construction contract;
- the Principal's desire to urgently get the Contractor onto the site to commence work/order materials;
- the declining use of the letter of acceptance in favour of extensive negotiation with the successful tenderer.

The issues that arise out of the use of letters of intent include:

1. whether a contract has been formed<sup>1</sup>;
2. whether an ancillary contract to perform the Works until a contract for the substantive part of the Works is formed upon the execution of a formal document by the parties<sup>2</sup>;
3. the Contractor's rights where the Principal ultimately declines to proceed with the project.<sup>3</sup>

Other issues have arisen in this context such as, for example, whether the Principal's consultants had authority, or ostensible authority, to enter into a contract on the Principal's behalf<sup>4</sup>. Such issues will depend on the particular circumstances and are beyond the scope of this paper. They impinge, however, on the letter of intent discussion and are therefore of some interest in that context.

It is not only in the area of construction contracts that letters of intent issues arise. Analogies (and guidance) can be derived from recent authorities in the following areas:-

- letters of comfort<sup>5</sup>;

---

<sup>1</sup> See, for example, **British Steel Corp v Cleveland Bridge and Engineering Co Ltd** [1984] 1 All ER 504

<sup>2</sup> See, for example, **Turrif Construction Ltd v Regalia Knitting Mills Ltd** [71] 9 BLR 24.

<sup>3</sup> Invariably, where the Court has found that no contract has been created (and no ancillary contract has been created), the Court has given the Contractor a quantum meruit remedy as, for example, in **Sabemo Pty Ltd v North Sydney Municipal Council** [1977] 2 NSWLR 880.

<sup>4</sup> Where, for example, the Principal's Architect sends a letter of intent, but in fact the Principal's Memorandum and Articles of Association require contracts to be executed under seal.

<sup>5</sup> See, for example, **Kleinwort Benson Ltd v Malaysian Mining Corporation Berhad** [1988] 1 WLR 799 (at first instance); [1989] All ER 785 (on appeal).

- intending joint venture agreements<sup>6</sup>;
- promissory estoppel cases<sup>7</sup>.

In this paper, I have attempted to bring some of these areas together to draw some general conclusions and to support the views expressed.

## 2. GENERAL PRINCIPLES

The principles affecting the formation (or not) of contracts where an offer or acceptance is said to be:

“...subject to contract....”

were set out extensively in **Masters v Cameron**<sup>8</sup>.

The High Court identified three possible meanings of the phrase, the meaning to be adopted in each depending on the particular circumstances.

The words used by the parties, therefore, are never the sole consideration. The intention of the parties, as evidenced by the circumstances in each case, is the critical matter to be discerned by the Court.

The Courts in the United Kingdom have appeared to start from the premise that a “letter of intent” will **usually not** result in the formation of a contract<sup>9</sup>.

In the **British Steel**<sup>10</sup> case, the Principal wrote to the Contractor advising of its intention to enter into a supply contract and proposing a number of terms (at no stage ever agreed). The parties continued to send correspondence to each other asserting their respective preferred terms, but never achieving agreement. The Contractor completed the Contract. The Principal asserted that the Contractor was liable for damages for late delivery (the delivery schedule being one of the matters which had not been agreed).

The Court found:-

1. no contract had been formed;
2. the Contractor was entitled to recover on a quantum meruit (even though the Contract had been completed);
3. it was possible for a contract to be created by a letter of intent (though none had been created here).

In relation to whether a contract had been created, His Honour re-affirmed that:-

---

<sup>6</sup> See, for example, the discussion of **United Dominions Corporation Limited v Brian Pty Limited** [1985] 60 ALR 741.

<sup>7</sup> See, for example, the discussion below of **Waltons Stores (Interstate) Ltd v Maher** [1988] 62 ALJR 118.

<sup>8</sup> (1954) 91 CLR 353.

<sup>9</sup> See, for example, the passage from **Turriff** set out below.

<sup>10</sup> See note 1 above.

“There can be no hard and fast answer to the question whether a letter of intent will give rise to a binding agreement; everything must depend on the circumstances of the particular case.”

His Honour went on to distinguish two ways in which a letter of intent could result in a binding contract:-

1. an executory contract under which each party assumes reciprocal obligations to each other; or
2. an “if” contract, whereby one party promises to do something (for example, pay him) if the other party performs certain reciprocal obligations, and that other party in fact performs those reciprocal obligations (before the offer is withdrawn).

**Points to Note:**

- **in most instances, the Contractor is likely to achieve payment on a quantum meruit where there is no contract;**
- **where either party is asserting a breach of contract, it is necessary for that party to establish that a contract has been created.**

Courts in the USA have (equally) been less persuaded by the words used to describe the letter of intent, and more reliant on the particular facts.

For example, in **Apco Amusement Company, Inc v Wilkins Family Restaurants of America, Inc**<sup>11</sup> the parties to a prospective lease entered into a document which provided, in part, as follows:

“This is a letter of intent between...to set up an amusement center (sic.)...

Mr Wilkins agrees to furnish ...1400 square feet at the above address and agrees to do the following things:

A. Remodel the interior...

APCO will place an order for the required machines upon acceptance of this letter by both parties.

This letter of intent is hereby accepted this...”

The letter was signed by both parties.

The Court of Appeals of Tennessee found that (the Court of first instance) was correct in finding that the letter constituted a binding agreement.

The Court spelt out the test as follows:

“In determining whether or not the letter should be construed as a binding contract, we must keep in mind that the ‘primary test as to the actual character of a contract is the intention of the parties, to be gathered from the whole scope and effect of the language used, and mere verbal formulas, if inconsistent with the real intention, are to be disregarded. It does not matter by what name the parties chose to designate it. But

---

<sup>11</sup> (1981) 673 S.W.2d.523.

the existence of a contract, the meeting of the minds, the intention to assume obligations, and the understanding are to be determined in case of doubt not alone from the words used, but also the situation, acts, and the conduct of the parties, and the attendant circumstances.”

The Court was persuaded by a number of factors, in the **Apco** case, including:-

1. the parties acted on the letter as if it were binding;
2. the letter was worded much like a contract (it set out the respective obligations, and used words like “agrees”, “accepts”);
3. the party attempting to deny the contract had, in fact, prepared the wording.

**Points to Note:**

- **there will probably be a natural presumption that a letter of intent would not create a binding contract;**
- **the acts, circumstances and other factors surrounding the letter of intent are relevant as to whether, in the particular case, a contract has been formed.**

### 3. CONSTRUCTION CASES

The usual dispute which occurs is when a contractor starts work on the strength of a letter of intent and the Principal ultimately decides not to proceed with the project.

The Contractor has two immediate concerns:

1. to be paid for the work that he has already performed (there is a further issue as to whether the Contractor is to be paid at the Contract rates or on a quantum meruit);
2. to establish whether he has a remedy against the Principal for breach of contract.

In **Turriff**<sup>12</sup>, the Contractor requested a letter of intent to “cover it” for design work under a proposed design and construction contract for extensions to a mill. The Principal wrote to the Contractor as follows:

“As agreed at our meeting...it is the intention of Regalia to award a contract to Turriff to build a factory...

All this to be subject to obtaining agreement on the land, and...

**The whole to be subject to agreement on an acceptable contract.”**  
[emphasis added]

The letter was signed by a director of the Principal.

Six months later, the project was cancelled and the Principal denied liability for the Contractor’s design work to that date.

Judge Fay found as follows:-

---

<sup>12</sup> See note 2.

1. The parties had turned their minds to the obligation to pay for the design work at the time that the Contractor had requested, and been given, the letter of intent. As a result, **the Contractor failed in its quasi-contract claim for a quantum meruit.**
2. The parties had **not** achieved agreement on the formal (substantive) contract.
3. The pre-contract discussions, and the request for and the giving of the letter of intent resulted in the formation of an **ancillary** contract, for the interim work.

His Honour said<sup>13</sup>:-

“A Letter of Intent will ordinarily have two characteristics, one, it will express an intention to enter into a contract in future and two, it will itself create no liability in regard to that future contract.”

#### Points of Interest:

- **The Contractor might have recovered on a quantum meruit but for the express agreement as to payment for the interim work;**
- **The Court found the “subject to...” qualification to be compelling evidence that the substantive contract had not been formed;**
- **The actions (pre-contract negotiations, letter of intent) of the parties can result in an ancillary contract.**

It is submitted that contractors will **usually** be able to recover payment for work performed pursuant to a letter of intent, either on a quantum meruit OR pursuant to an ancillary contract<sup>14</sup>.

#### 4. LETTER OF COMFORT CASES

Two recent letter of comfort cases have possibly provided some further insight into how the Courts may choose to deal with letter of intent cases.

In **Kleinwort Benson**<sup>15</sup>, a British financier lent 5 million pound<sup>16</sup>s to a Malaysian mining company. The lender requested a letter of comfort from the borrower’s parent company. The parent wrote as follows:-

“...It is our policy to ensure that the business of (the borrower) is conducted in such a way that (it) is at all times in a position to meet its liabilities to you...”

---

<sup>13</sup> At page 32.

<sup>14</sup> This observation was made by Rober Goff J. in **British Steel**, at page 509. His Honour said:  
 “In most cases, where work is done pursuant to a request contained in a letter, it will not matter whether a contract did or did not come into existence because, if the party who has acted on the request is simply claiming payment, his claim will be based on a quantum meruit, and it will make no difference whether the claim is contractual or quasi-contractual...”

<sup>15</sup> See note 5 above.

<sup>16</sup> Later increased to 10 million pounds.

There was a subsequent liquidity crisis in the tin industry and the financier made a demand on the parent, based on the letter of comfort.

At first instance, Hirst J. found for the financier<sup>17</sup>. Importantly, Hirst J. was particularly persuaded by the events leading up to the preparation of the letter, and the obvious and strong reliance on that letter by the financier when advancing the funds<sup>18</sup>.

The case was subsequently overturned on appeal. The Court of Appeal reasoned that:

- the statement as to “ensuring” the subsidiary’s ability to meet its obligations was cast in the present tense and did not constitute a promise to maintain that policy;
- there was no express promise to pay.

No doubt the case was correctly dealt with by the Court of Appeal. The critical consideration was the intention of the parties. Australian Courts, however, may be more attracted to the reasoning of Hirst J.

In **Banque Brussels Lambert S.A. v Australian National Industries Ltd**<sup>19</sup> a recent decision of the Judge in Charge of the Supreme Court of New South Wales Commercial Division<sup>20</sup>, an Australian company (ANI) undertook not to dispose of its 45% shareholding in a subsidiary<sup>21</sup> in consideration the lender making a US\$5m advance to another subsidiary.

The letter of comfort had provided:-

“It would not be our intention to reduce the shareholding...  
(We) will ensure that...(the borrower) will at all times be in a position to meet its financial obligations as they fall due...”

In fact, in direct breach of the terms of the letter, the parent disposed of its shareholding, and the borrower went into liquidation. The lender sued on the letter of comfort.

Rogers CJ found that ANI had breached its contractual promises<sup>22</sup>. His Honour appeared to place substantial weight on the promises being uttered “in the course of business”. His Honour reasoned that such promises would usually be presumed to have been intended to be enforceable, unless there was evidence to the contrary.

His Honour said<sup>23</sup>:-

“...there should be no room in the proper flow of business for some purgatory where statements made by businessmen, after and made to induce another business person to enter into a business transaction would, without any express statement to that effect, reside in a twilight zone of merely honourable engagement.”

---

<sup>17</sup> It is probably accurate to say that this caused some concern to large corporate borrowers.

<sup>18</sup> It might be thought strange that this reliance could be a strong factor, in light of a pervasive view amongst financiers that letters of comfort were **not** legally binding (at least, no prior to this decision). Letters of intent, in contrast, perhaps, are generally perceived (perhaps wrongly) in construction circles to be legally binding (at least to the extent that such a letter provides a firm basis for a quantum meruit claim).

<sup>19</sup> Unreported, handed down 12 December 1989.

<sup>20</sup> Rogers J.

<sup>21</sup> Spedley Holdings Limited.

<sup>22</sup> The damages issue was to be resolved in separate litigation.

<sup>23</sup> At page 39 of the judgment.

## **5. ACTIONS BY UNSUCCESSFUL TENDERERS**

In theory, the Principal is not obliged to consider any tender, nor is he liable for failing to accept any tender or any other matter in relation to the tender. The tender documents, themselves, will usually contain an express exclusion of such liability.

From time to time, however, unsuccessful tenderers have sought to claim damages from the Principal in respect of their unsuccessful tender.

For example, a tenderer who prepares a detailed tender responses and estimates, and submits his tender, only to find (at least in his mind) that his tender has not even been considered, may assert that he is entitled to claim the cost of preparing that tender on the basis of contract. The contract which the tenderer in such circumstances would be asserting would be one whereby the Principal, in return for the tenderer agreeing to prepare and submit a detailed tender document, agrees to consider that tender and to act fairly in relation to choosing between the respective tenderers.

In certain circumstances, from time to time, some tenderers have asserted a breach of contract by the Principal when the proposed contract, the subject of the original tender, is later changed between the Principal and one or more short listed tenderers, after other tenderers have been excluded from the tender process.

In all such cases, the tenderers claim will be based in contract