

## **We Do Intend to Contract with You, and May Actually Just Have!**

***By Jonathan Gold***

Letters of intent are a necessary evil in the construction industry. Although it would clearly be better for everyone if all of the terms and conditions of the contract were finalised and a formal contract entered into before works were commenced, this is unfortunately rarely possible.

Employers are usually eager, once a contractor has been selected, for the work to begin and therefore be completed as soon as possible. However, there is invariably still a lot of work to do, and negotiations to take place, before a contract can be drawn up. To prevent any delay whilst the contract is being finalised, the employer will instruct the contractor to commence works under a letter of intent, on the basis that in due course a formal contract will be entered into.

The phrase “letter of intent” is not a term of art. It is simply a description of the typical arrangement under which a contractor commences works with no formal contract in place: the employer usually instructs the contractor to commence the works by way of a letter in which it states its intention to enter into a formal contract with the contractor in due course. The meaning and effect of a letter of intent, for example, whether a contract has actually been formed at this stage, and what are the parties’ rights and obligations arising out of the letter, ultimately depend on the content of the letter and the relevant circumstances.

There have been two recent cases that provide some illustration of when letters of intent should and should not be used, and the difficulties that can arise when they are used.

### **Cunningham and others v Collett and another [2006] EWHC 1771 (TCC)**

In this case an employer was claiming, amongst other things, that its architect had been negligent in failing to advise that it was inappropriate for the contractor to be instructed to commence works under a letter of intent. In assessing the claim His Honour Judge Peter Coulson Q.C. made some useful general comments about letters of intent.

He agreed that letters of intent are used unthinkingly in the construction industry, and that they are often used, wrongly, to put off difficult contractual issues in the hope these will be resolved in due course once the works are underway. He also highlighted the practical problem that once works have been commenced under a letter of intent, the parties are so taken up with the works that finalising the contract becomes of minor importance. He did however conclude that if the employer wants the works to be commenced promptly, and the contractor is agreeable to this, a “a careful letter of intent” can be appropriate in the following limited circumstances: (a) where the workscope and price are either agreed, or there is a clear mechanism in place for these to be agreed; (b) the terms and conditions are, or are very likely to be agreed; (c) the start and finish dates and the programme are

broadly agreed; and (d) there are good reasons for the works to be commenced in advance of the contract documents being finalised.

His Honour did however highlight that where a letter of intent was used there was the obvious risk that in due course a formal contract would not be entered into, and a letter of intent should be carefully drafted so to minimise the risk to both parties of this eventuality.

### **ERDC Group Limited v Brunel University [2006] EWHC 687 (TCC)**

The problems that can arise when a letter of intent is used were well illustrated in this case.

ERDC was instructed to commence and carry out works pursuant to five successive letters of intent because Brunel University did not want to enter into a formal contract until full planning permission for the development was granted. When Brunel eventually issued formal contract documents to ERDC, shortly before the majority of the works were completed, ERDC refused to execute them, and claimed it was entitled to be paid on a *quantum meruit* basis rather than in accordance with the valuation rules of the contract both parties originally envisaged they would be entering into. As the last letter of intent expressly stated that ERDC's appointment under the letter would terminate on a specific date, and no subsequent agreement was entered into, it was common ground that a contract did not exist thereafter. What was at issue, rather unusually, was whether there was a contract between the parties for the preceding period, and, if so, what were the terms and conditions of the contract.

The five letters of intent were very similar. The reference of each letter was a brief description of the project; the letters detailed ERDC's tender sum; they made reference to the periods in ERDC's construction programme; stated that "work shall be paid for in accordance with the normal valuation and certification rules of the JCT Standard Form of Building Contract with Contractor's Design", up to a specified maximum; instructed ERDC to commence the works; and stated that until a formal contract was entered into ERDC's appointment would be governed by the terms of the letter. The first three letters were countersigned by ERDC, but not the subsequent two.

His Honour Humphrey Lloyd Q.C. found from the text of the letters, which was relatively standard, that there was a clear intention to create legal relations, and sufficient certainty of essential terms. He concluded therefore that a contract had been formed as a result of the letters of intent, with each letter superseding the previous one. Although the last two letters were not countersigned by ERDC, its conduct, in continuing to carry out the works without objection, was construed to be acceptance of each letter.

Interestingly His Honour construed "in accordance with the normal valuation and certification rules" of the JCT conditions to mean that the amount ERDC was to be paid was to be determined by reference

to clauses 12 (changes), 13 (contract sum), 30 (payments) and, surprisingly, 26 (loss and expense). Even more surprisingly, he also found that the contract contained a mechanism for extending time, as the JCT conditions contained such provisions, even though these provisions were not expressly referred to in the letters of intent. Although nothing turned on this finding.

### **Conclusion**

The courts accept that there are limited circumstances where it is appropriate to use a letter of intent, and the judgment in Cunningham contains useful guidelines on this. However, where a letter of intent is used, it must be borne in mind what may happen if a formal contract is not subsequently entered into promptly, as illustrated in ERDC.

### **Jonathan Gold**

jgold@sheridangold.co.uk