Legal Issues Arising from Letters of Intent

by

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A. INTRODUCTION

1. In the construction industry, letters of intent are regularly used by parties to evince an intention to enter into a contract. For example, after a tenderer succeeds in a competitive tender, it is common practice for it to rely on the developer’s letter of intent to initiate work and to line up subcontractors in a similar manner.

2. The commercial advantages of using a letter of intent are obvious. It provides flexibility such that details of the contractual agreement may be varied at a later stage while preparatory work can be commenced in the interim. It is also a convenient and expedient way to ensure future supplies or work. However, the flip side of this informal arrangement is that it is often difficult to ascertain whether a letter of intent gives rise to any and if so, what liability.

3. Depending on the facts of each case, actions for work done arising from letters of intent have largely been based on contract or restitution (or both). This paper will highlight, with case examples, some of the contractual and restitutionary issues arising from letters of intent, the difficulties from some of the decisions, followed by suggestions on how to avoid potential pitfalls in using letters of intent.

B. ACTIONS BASED ON CONTRACT

Problems with pure letters of intent

4. To establish a binding contract, certain elements must be present. For example, there must be an intention to create a legally binding relationship between the parties. There must also be unequivocal acceptance of an offer which clearly stipulates all the terms essential to the existence of the agreement. However, letters of intent in the construction industry are usually problematic on these two grounds as they are frequently used when the parties only intend to enter into a binding contractual relationship in the future and/or when the detailed scope of works and contractual arrangements are yet to be finalised.

5. Therefore, in general, “a letter of intent 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.”² After all, a contract to negotiate is a contract which is not known to English law.

6. For example, in Peter Lind & Co Limited v Mersey Docks and Harbour Board³, Peter Lind submitted alternative tenders, one stipulated fixed price and the other variable price, to MDHB for

¹ Russell Coleman is a Senior Council, Temple Chambers
² Turriff Construction Limited v Regalia Knitting Mills Limited (1971) 9 BLR 20 at 29
³ Peter Lind & Co Limited v Mersey Docks and Harbour Board
the construction of a container freight terminal. MDHB purported to accept the tender formally, but did not specify which pricing mechanism it preferred. Peter Lind finished the work. The court held that the inconclusive negotiations as to price precluded the finding of any contract, but it awarded a quantum meruit to Peter Lind for the work done.

7. Similarly, in British Steel Corporation v Cleveland Bridge & Engineering Co Limited⁴, the court held that there was no contract as the letter of intent lacked all the essential terms, such as price and delivery dates and the plaintiff was reimbursed on a quantum meruit basis (discussed further below in Part C).

8. It should be noted though, that if subsequently the parties are able to conclude a formal contract, the courts may be prepared to imply a term that this contract should be retrospectively applicable to all the work done in pursuance of the original letter of intent⁵.

Letters of intent with binding effect

9. On the other hand, it can be seen that the courts have been inclined to finding a contract provided that the letter of intent contains all the key terms (such as scope of works, price, completion dates, etc.).

10. In Mirant Asia-Pacific Construction (Hong Kong) Limited v Ove Arup & Partners International Limited (No. 1)⁶, Mirant was the design and build contractor for a power station in the Philippines. Arup was to be retained to provide engineering services. A letter of intent was signed by both parties providing that the fee for ‘concept, preliminary and detailed design’ was to be £3.75 million. The letter recorded that details such as payment mechanism and contractual arrangements would be defined in greater detail later.

11. Arup duly commenced work and the parties continued to negotiate with a view to entering into a formal contract. A few months after the letter of intent was signed, Arup provided to Mirant a draft services agreement, which provided a limitation on Arup’s liability of £4 million, a limitation of time for bringing a claim against Arup, and a completion date. The document was neither accepted nor rejected by Mirant.

12. No further negotiations took place in relation to the formalisation of the contract but work continued. Following the completion of the works, Mirant made a claim substantially in excess of the alleged £4 million cap and its legal proceedings were also commenced after the limitation period under the draft services agreement.

13. The Court of Appeal held that the original letter of intent constituted a binding agreement between the parties which covered the work to be undertaken by Arup, since it was sufficiently clear in relation to the scope of work, price and other relevant terms. Furthermore, as the subsequent conditions were not explicitly accepted (albeit not explicitly rejected either), they did not constitute a

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³ [1972] 2 Lloyd’s Rep 234
deleted
⁴ [1984] 1 All ER 504
⁵ Trollope & Colls Limited v Atomic Power Constructions Limited [1963] 1 WLR 333
⁶ [2003] 92 Con LR 1
variation to the letter of intent or alternatively a new contract. Therefore, Mirant was not debarred from making its claim against Arup.

14. A similar conclusion was arrived at in *Harvey Shopfitters Limited v ADI Limited*. Here, Harvey offered a tender to ADI for a lump sum of £340,000. ADI informally indicated through a letter of intent saying that it was its intention to enter into a contract with Harvey in the lump sum of £340,000. It also stated:

“If, for any unforeseen reason, the contract should fail to proceed and be formalised, then any reasonable expenditure incurred by you in connection with the above will be reimbursed on a quantum meruit basis.”

15. No formal contract was ever prepared and works were completed under the letter of intent. Harvey claimed an entitlement to be calculated on a quantum meruit basis but ADI argued that there was a binding agreement in respect of the lump sum of £340,000.

16. The Court of Appeal endorsed Dyson J’s approach in *Stent Foundations Limited v Carillion Construction (Contracts) Limited* and held that the mere fact that the parties envisaged the execution of a further document does not preclude the court from concluding that a binding contract was nonetheless entered into, provided that all the necessary ingredients of a valid contract are present. In this case, it was not disputed that there was nothing left to agree and the letter of intent constituted a binding contract. Hence, Harvey was limited to recovery of the agreed lump sum amount.

**Part-contract letters of intent**

17. However, the situation is nowhere as clear when the letter of intent seeks only to regulate part of the works by, for example, limiting the financial exposure of the employer while work gets underway, and the contractor extends work beyond that limit.

18. In *Mowlem plc v Stena Line Ports Limited*, the action arose out of the construction of Holyhead Terminal 5. Mowlem undertook the works on behalf of Stena under a series of letters of intent, all of which conveyed an intention to formalise a contract, but the parties never concluded any formalised contract. In the last letter of intent dated 4 July 2003, it was stated that if Mowlem continued to carry out the work in accordance with the intended contract, Stena would pay a reasonable sum for the works up to a maximum of £10 million until 18 July 2003. Mowlem replied and said that it was proceeding on the assumption that the cap of £10 million did not apply to the works in relation to an unforeseen discovery of rock in the ground and that, in any event, the figure of £10 million was considerably less than the work would in fact cost and it should be increased. Stena did not respond to Mowlem.

19. Work continued beyond 18 July 2003 and the value of the works considerably exceeded the £10 million cap. Mowlem claimed that it was entitled to be repaid on a quantum meruit basis and Stena

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7 [2003] 91 Con LR 71  
8 [1999] 78 Con LR 188 at 191-192  
9 [2004] EWHC 2206
was estopped from relying upon any limit. On the other hand, Stena argued that the value was capped at £10 million.

20. Seymour J held that the last letter of intent dated 4 July 2003 constituted the contractual agreement between the parties and Stena’s intention to limit its financial exposure to £10 million was clear. It would make no commercial sense to have a financial limit which could be avoided by continuing to carry out work after the prescribed time or simply by Mowlem exceeding that limit. With regard to the issue of estoppel by representation, on the facts the judge was not satisfied that Stena conducted itself in such a way as to lead Mowlem to believe that it would not seek to rely upon the terms of the last letter of intent.

21. On the contrary, a different result was achieved in AC Controls Limited v BBC. In this case, works were carried out under a letter of intent stating that if a formal agreement was not concluded, the total amount payable to AC would be limited to either the value of the work executed or the authorised value at £1 million. In the end the parties did not sign any formal agreement and the contractor incurred expenses over £1 million. The judge took the view that the value of £1 million merely provided an index beyond which the employer could terminate the arrangement between the parties and it did not place a limit on the contractor’s entitlement. In this case, as the employer did not terminate the arrangement after the expenditure reached £1 million, consequently the contractor succeeded in its claim for recovery of its full costs.

22. The two cases are difficult to reconcile particularly in view of the fact that:

(i) Stena was aware that the works were being extended beyond 18 July;

(ii) as in AC Controls, both parties were aware that the works are being undertaken in excess of the £10 million limit yet Stena did not choose to terminate the arrangement;

(iii) Mowlem made it clear that they were proceeding on the basis that the £10 million limit did not apply to the unforeseen discovery of the rock.

The Australian approach

23. In Australia, Mowlem’s claim would probably have been allowed by virtue of the principles under Sabemo Pty Limited v North Sydney Municipal Council or promissory (equitable) estoppel.

24. In the Sabemo case, Sabemo had won a tender from the defendant council for the development of a civic centre. The parties’ understanding was that a firm contract would not be made until the plans had been agreed. At the council’s request Sabemo submitted several sets of estimates and plans. However, in the end the council decided to abandon the project. Sheppard J in the Supreme Court of New South Wales upheld Sabemo’s claim and his reasoning is that:

“...where two parties proceed upon the joint assumption that a contract will be entered into between them, and one does work beneficial for the project, and thus in the interests of the two parties, which work he would not be expected, in other circumstances, to do...”

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10  [2002] 89 Con LR 52
11  [1977] 2 NSWLR 880
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25. However, the difficulty with this decision is that it is unclear on what basis Sheppard J allowed Sabemo’s claim. On the one hand, he explicitly denied that the case was one of unjust enrichment. On the other hand, it was common ground that no contract had been formed yet, on the above passage, the judge seemed to be awarding expectation or reliance loss to Sabemo.

26. In the subsequent landmark case of *Waltons Stores (Interstate) Limited v Maher*[^13], this analytical difficulty was overcome by allowing equitable estoppel to be used as a cause of action. In the case, Brennan J identified the following six elements that are necessary to establish an equitable estoppel[^14]:

   (i) the plaintiff assumed that a particular legal relationship then existed between the plaintiff and the defendant or expected that a particular legal relationship would exist between them and, in the latter case, that the defendant would not be free to withdraw from the expected legal relationship;

   (ii) the defendant has induced the plaintiff to adopt that assumption or expectation;

   (iii) the plaintiff acts or abstains from acting in reliance on the assumption or expectation;

   (iv) the defendant knew or intended him to do so;

   (v) the plaintiff’s action or inaction will occasion detriment if the assumption or expectation is not fulfilled; and

   (vi) the defendant has failed to act to avoid that detriment whether by fulfilling the assumption or expectation or otherwise.

27. For the purposes of the second element, a defendant who has not actively induced the plaintiff to adopt an assumption or expectation will nevertheless be held to have done so if:

   (i) the assumption or expectation can be fulfilled only by a transfer of the defendant's property, a diminution of his rights or an increase in his obligations and

   (ii) he, knowing that the plaintiff’s reliance on the assumption may cause detriment to the plaintiff if it is not fulfilled, fails to deny to the plaintiff the correctness of the assumption or expectation on which the plaintiff is conducting his affairs.

28. These six elements have been applied in the context of letters of intent in the construction industry, such as *Leading Edge Events Australia v TE Kanawa*[^15].

[^12]: ibid, at pp. 902 – 903
[^13]: [1988] 164 CLR 387
[^14]: ibid., at 428 – 429
[^15]: [2007] NSWSC 228
29. However, in most of the Commonwealth jurisdictions (including in the UK), equitable estoppel remains a shield (defence) and not a sword (cause of action).

30. The position in Hong Kong was reviewed recently in the Court of Appeal\(^\text{16}\), when it was held that the wider approach adopted by the High Court of Australia in the *Walton Stores* case of permitting reliance on estoppel by convention irrespective of any pre-existing cause of action should not be followed, as that would lead to the consequence that such estoppel would have provided a factual foundation for enforcement of a ‘contract’, notwithstanding that the facts demonstrated that no binding contract was actually made.

31. The Court of Final Appeal very recently\(^\text{17}\) recognized some differences have developed as between Australian and English jurisprudence in relation to the constituents of certain estoppels, with the Hong Kong courts “presently inclining” towards the English approach. But it also emphasised that there is no divergence among the jurisdictions regarding the court’s wide and flexible discretion to grant appropriate relief.

**C. ACTIONS BASED ON RESTITUTION**

**The governing principles**

32. As shown above, where a letter of intent is found to be non-binding for want of contractual intention or certainty, a plaintiff would most likely plead its case in terms of restitution. A restitutionary claim is predicated upon the principle of unjust enrichment, i.e. the defendant has received a benefit at the expense of the plaintiff and it is unjust in the circumstances for the defendant to retain that benefit\(^\text{18}\). To establish unjust enrichment in the context of work done in reliance on a letter of intent, the defendant must have an opportunity to reject the work and must know that the work was not offered for free\(^\text{19}\). If there was no rejection from the defendant, the plaintiff will be entitled to a quantum meruit or quantum valebant assessed by the court at a reasonable rate.

**Cases in which restitution was granted**

33. A leading case example is *British Steel Corporation v Cleveland Bridge & Engineering Co Limited*\(^\text{20}\). BSC entered into negotiations with CBE for the manufacture of 137 cast steel nodes for the centre of the steel frame of a bank in Saudi Arabia. CBE were subcontractors responsible for the steel work on the building. After discussion of the specifications required, CBE sent a letter of intent requesting BSC to “proceed immediately ... pending the preparation and issuing to you of the official form of contract”. BSC wanted to manufacture on its own terms and negotiations continued, but no formal contract was ever agreed. BSC delivered the nodes and claimed £229,832 as the price of the nodes.

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\(^{16}\) Unruh v Seeberger [2005] 4 HKC 175

\(^{17}\) Glory Rise Limited v Luo Xing Juan Angela, FACV 32/2007, 16 June 2008

\(^{18}\) Goff & Jones, *The Law of Restitution* (7th ed), §1-012

\(^{19}\) ibid., §1-019

\(^{20}\) [1984] 1 All ER 504
34. Goff J (as he then was) held that there was no contract because the letter of intent did not contain all the essential terms, such as price and delivery dates. However, he allowed BSC’s claim on a quantum meruit basis at £229,832.

35. In *William Lacey (Hounslow) Limited v Davis*\(^{21}\), the plaintiffs submitted a tender for building work in relation to premises which had suffered war damage. They were given the understanding by the defendant owner of the land that the contract would be theirs. Subsequently at the defendant’s request the plaintiffs submitted detailed and revised estimates of the proposed work, which the defendants used in making a war damage claim to the War Damages Commission. However, the parties failed to conclude a building contract and the defendant sold the land. The plaintiffs were awarded a quantum meruit for the work done at the defendant’s request.

**Case in which restitution was refused**

36. Contrary to the above cases, in which the plaintiffs succeeded in their quantum meruit claims, restitution was refused in *Regalian Properties Limited v London Docklands Development Corp*\(^{22}\). In this case, the plaintiff property developers submitted to the defendant a tender of £18.5 million for residential development of part of the docklands area of London. The defendant accepted this tender in a letter headed ‘subject to contract’. Due to the defendant’s difficulties in obtaining vacant possession and fluctuations in the property market, the parties were ultimately unable to conclude a contract and the project was abandoned. The plaintiff claimed to be entitled to reimbursement under restitution of almost £3 million which they had paid to professional firms in respect of the proposed development in preparation for the intended contract.

37. Their claim was rejected by Rattee J for three reasons. Firstly, the work had been carried out on a ‘subject to contract’ basis, i.e. they knew that either party was free to withdraw from the negotiations even though they confidentially expected that this would not happen.

38. Secondly, the court was not satisfied that the defendant had been benefited by the work paid for by the plaintiff because the project had fallen through and the defendant did not, and was not entitled to, make use of the designs for developing the land.

39. Thirdly, contrary to both the *William Lacey* and *British Steel* cases, the work was not expressly requested by the defendant; and unlike the *British Steel* case, the work was not an accelerated performance of the anticipated contract but was carried out for the purpose of putting the plaintiff in a better position to obtain and perform the contract. Furthermore, the court expressly rejected the approach in *Sabemo* and considered that it had no application in England\(^{23}\).

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\(^{21}\) [1957] 2 All ER 712
\(^{22}\) [1995] 1 WLR 212
\(^{23}\) ibid., at 230 – 231
The relevant considerations

40. It would be helpful to consider *Countrywide Communications Limited v ICL Pathway*[^24], in which the court summarised from authorities a number of considerations for determining whether work done in anticipation of a formalised contract gives rise to any liability in restitution:

(i) whether the services were of a kind which would normally be given free of charge;

(ii) the terms in which the request to perform the services was made may be important in establishing the extent of the risk (if any) which the plaintiffs may fairly be said to have taken that such services would in the end be unrecompensed;

(iii) the nature of the benefit which has resulted to the defendant is important;

(iv) what may often be decisive are the circumstances in which the anticipated contract does not materialise and in particular whether they can be said to involve “fault” on the part of the defendant or (perhaps of more relevance) to be outside the scope of the risk undertaken by the plaintiff at the outset.

41. Although the case is concerned with a successful tender to supply advice on public relations and communications, it is suggested that these considerations are equally applicable in the context of the construction industry.

Potential difficulties in a restitutinary claim

42. These various authorities appear to show that restitution provides a satisfactory mechanism to resolve disputes arising from work done in anticipation of a contract which ultimately fails to materialise. However, on proper analysis, there are a number of practical difficulties in allowing a claim on restitutionary principles.

43. Firstly, the court has not laid down any general rules as to how a reasonable sum is to be assessed. Since there is no contract, a service provider is simply prohibited from relying on the price it would have received had an agreement been reached. In many circumstances, there may be little certainty as to the potential size of the award and the court would have to consider a wide range of factors, such as those stated in *Keating on Construction Contracts*[^25]:

> “Where a quantum meruit is recoverable for work done outside a contract, it is wrong to regard the work as though it had to any extent been performed under the contract. The contractor should be paid at a fair commercial rate for the work done. Where a quantum meruit is recoverable for work done pursuant to a void contract, it is wrong in principle to apply the provisions of the void contract to the assessment of the quantum meruit ... Useful evidence in any particular case may include abortive negotiations as to price, prices in a related contract, a calculation based on the net cost of labour and materials used plus a sum for overheads and profit, measurement of work done and

[^24]: [2000] CLC 324 at 349

[^25]: *Keating on Construction Contracts* (8th ed.), §4-020
materials supplied, and the option of quantity surveyors, experienced builders or other experts as to a reasonable sum.”

44. Secondly, a strict application of restitutionary principles in a commercial setting may risk ignoring important business considerations and rendering a result unjust.

45. This is best illustrated by the case of **British Steel**. BSC did not deliver all 137 steel nodes in one batch. Instead, it first delivered 136 nodes and retained the last one because the price had not been paid. As a result of the 1980 steel strike, the final node could not be delivered until much later. Bound by the completion deadline, CBE was heavily penalised as a result of the late delivery and hence it counterclaimed BSC for £867,335.

46. However, Goff J rejected CBE’s counterclaim because, as there was no contract, no terms as to delivery times could be implied. In other words, the rights and obligations in a restitutionary claim and those in a contractual claim can be mutually exclusive.

47. As pointed out by Ball, Goff J’s approach produced at least two areas of potential unfairness. Firstly, through the application of black or white conceptual reasoning, the buyer has to bear the whole of the risk of negotiations breaking down after performance has commenced. The seller receives reasonable expenses plus a profit, while the buyer has to pay for everything that he actually receives but gets no protection or guarantee as to the quality and timing of the performance. In theory, the buyer may choose to reject the goods or services. However, in practice, there may be circumstances in which the works have been proceeded to such an extent that it is no longer possible for the buyer to reject the goods or services without incurring even greater losses. For example, in **British Steel**, the option to reject the last node was simply not available to CBE after the strike commenced.

48. Secondly, there is either a fully-fledged contract or there is no contractual relation at all. Once it is concluded that there is no contract, it is impossible to imply any terms as to performance. Given the deadline imposed under the construction contract, CBE would have insisted on some protection against late delivery, e.g. by making time of the essence, or providing for an indemnity clause or an allowance against the price. The difficulty with excluding any implied considerations (however essential in the commercial setting) is that the court is binding CBE to an arrangement it would never have agreed to.

**D. SUGGESTIONS**

49. Based on the discussion above, it seems that neither the principles of contract nor those of restitution can on their own adequately address the legal issues arising from work done in reliance on letters of intent. Therefore, it is important to seek to avoid potential pitfalls by adopting appropriate preventative measures.

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26 [1984] 1 All ER 504 at 511 b-c
27 Ball, “Work carried out in pursuance of letters of intent – contract or restitution?” [1983] LQR 572 at 577
28 ibid., at 578
29 This dichotomy was also apparent in **Comtech Engineering & Consultants Co Limited v Thorn Security (HK) Limited** HCCT 53/1999, 30 April 2003, Ma J, at §23
50. Obviously, it is most ideal if parties can formally enter into a contractual relationship or ensure that a letter of intent contains all the necessary ingredients of a binding agreement. In that event, the rights and obligations of the parties are regulated and any dispute arising from the arrangement can be resolved relatively easily by reference to the terms of the contract/letter of intent. In practice, this may be difficult to achieve as letters of intent are used precisely for the purpose of flexibility such that a contractor may proceed with the works while the parties negotiate on the details at a later stage. However, parties should be constantly reminded to continue with their negotiations with a view to entering into a formal contract.

51. Where it is impossible to conclude a contract for the entirety of the works, parties may opt for a letter of intent which provides for the scope of the works in the interim. In that case, there is usually a binding contract in respect of those specified works. However, the position is unclear when the contractor extends the works beyond that scope or financial limit and both parties are aware of the situation.

52. As it is unlikely that Hong Kong courts will in the near future adopt the Australian approach in *Waltons Stores*, it is suggested that contractors should be cautious when undertaking works beyond the specified scope or financial limit. It may be prudent for them to seek written confirmation from the employer as to the latter’s intention to continue with the works.

53. At the same time, employers should regularly check on the progress of the project. If it transpires that the original limit has been exceeded against the employer’s wish, it should consider whether to suspend or terminate the arrangement before the terms for the remaining works are finalised. In this regard, the employer may consider providing in the letter of intent that the contractor should cease work and vacate the site on the employer’s written instruction; and if the work is stopped, there can be no claim for overheads or profits by the contractor in respect of any outstanding work.

54. Furthermore, to avoid the presumption that the terms of the letter of intent are not intended to apply to the whole of the works if no formal contract is ever entered into, the letter of intent may provide that the financial limit may be varied as the works proceed.

55. Where a letter of intent does not constitute a contract at all, a contractor would have to rely on restitution to make its claim in relation to the goods and services provided. If restitution is granted, an employer is simply debarred from making any counterclaim as to performance.

56. To protect its position, an employer is suggested to be expedient in concluding a contract (with the necessary protection mechanism) before it is no longer possible for it to obtain alternative suppliers or reject the goods and services. It may consider increasing the pressure on the contractor to enter into a formal contract as quickly as possible, by including a provision that the contractor is not entitled to any payment for profit or overheads under the letter of intent. If the relationship is one between an owner and a nominated sub-contractor, the owner may wish to ensure the signing of the warranty by the nominated subcontractor so that it would allow a cause of action in the event that there is defective performance and/or undue delay in completion.
57. On the whole, despite the many legal issues that may potentially arise, it must be emphasised that letters of intent are not objectionable provided that they are carefully drafted and used under appropriate circumstances, for example, where:

(i) the contract work scope and the price are either agreed or there is a clear mechanism in place for such work scope and price to be agreed;

(ii) the contract terms are (or are very likely to be) agreed;

(iii) the start and finish dates and the contract programme are broadly agreed;

(iv) there are good reasons to start work in advance of the finalisation of all the contract documents. 30

E. CONCLUSION

58. The commercial advantages of a letter of intent are no doubt obvious but it should not be considered as a permanent substitute for a formal contract. Employers and contractors must not be complacent by allowing a potential claim to snowball behind a letter of intent which offers no or insufficient protection to the parties. Instead, they should continue their negotiations with a view to entering into a binding agreement, or at the very least, conduct regular reviews of the progress of the works.

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30 Cunningham v Collette & Farmer [2006] EWHC 1771 at §90
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