LETTERS OF INTENT—HIGHLIGHTING THE DANGERS

James Williams, Associate

Carter Newell Lawyers, Brisbane

A letter of intent is a document sometimes used to engage a contractor or a subcontractor in circumstances where the principal is not in a position to enter into a building contract.

A letter of intent may be used in various circumstances, for example, where a contractor needs to order items with a long 'lead' time, i.e., items that may need to be specifically ordered for the project such as structural steelwork, or where the contractor is under a tight programme and needs to start work to ensure the principal's time scale is met, notwithstanding that the principal is not yet in a position to issue the building contract for execution.

However letters of intent are often the subject of dispute, especially where the actual contract is never executed. A recent English case has highlighted this issue. In the case of Mowlem Plc (Trading as Mowlem Marine) v Stenna Line Ports Limited [2004] EWHC 2206 (TCC) Mowlem Plc was engaged by Stenna to construct a new ferry terminal at the port of Holyhead on the Welsh island of Anglesey. Mowlem was originally engaged under a letter of intent dated 17 October 2002 to secure and mobilise marine plant and drilling equipment, up to the value of £400,000.

In total fourteen separate letters of intent were signed between the parties, each replacing the last, however the actual contract was never executed.

Litigation resulted after the fourteenth letter of intent was issued on 4 July 2003, which purported to authorise Mowlem to complete the works, up to Stenna's maximum liability of £10,000,000 by 18 July complete the works, up to Stenna's was issued on 4 July 2003, which purported to authorise Mowlem to 2003. Mowlem continued works past 18 July 2003, in excess of £10,000,000 and claimed payment of a 'reasonable sum' as consideration for the additional works it had performed.

Stenna denied liability for this and claimed its total liability to pay Mowlem was capped at £10,000,000 as stated in the fourteenth letter of intent.

The court found in favour of Stenna and refused to imply a term into the fourteenth letter of intent that Mowlem would be entitled to payment of a reasonable sum for works performed in excess of £10,000,000. Stenna's maximum liability was therefore capped at £10,000,000. This did of course leave Mowlem in the uncomfortable position of having provided works to a value in excess of £10,000,000 without being able to claim an additional payment.

This case must however, be contrasted with the Australian case of Abigroup Contractors Pty Ltd v ABB Service Pty Ltd (formerly ABB Engineering Construction Pty Ltd) [2004] NSWCA 181. The case concerned the construction of the Multi Use Arena (now known as the Superdome) at Sydney Olympic Park. Abigroup was engaged to design and construct the Superdome. ABB assisted with the preparation of Abigroup's tender for the design and construction of the Superdome and tendered, as a subcontractor, for the fabrication and construction of the roof. ABB stated in its tender that it had concerns regarding the proposed subcontract conditions which would need to be resolved before a subcontract was entered into. In addition ABB had not seen the various project documents referred to in the subcontract and confirmed, in its tender, that it would need to review these documents. ABB's tender was submitted on 9 February 1998. During a meeting held on 19 February 1998, ABB was told that its tender of $14,000,000 was successful, and was issued with a letter of intent. The letter of intent stated that commencement by ABB would be deemed to be full acceptance of the subcontract agreement.

The following day (20 February 1998) ABB collected certain drawings from Abigroup. On the same day, ABB wrote to Abigroup confirming that some subcontract conditions needed to be resolved and in particular, a limitation of liability clause needed to be included in the subcontract. This was stated by ABB to be 'non negotiable'.

ABB began work on the fabrication and construction of the roof works on 25 February. There was much subsequent correspondence between the parties and various meetings were held. The parties came close to, but could not reach, final agreement. In mid June 1998, ABB asserted that no formal subcontract was in place and that it was carrying out the works on a quantum meruit basis (in which case ABB would be entitled to payment of a reasonable sum based on the value of the works provided by ABB). Abigroup asserted that a contract between the parties had come into existence on 19 February (although Abigroup, in subsequent proceedings, claimed

that the subcontract came into existence on a different date).

The dispute was referred to Robert Wensley QC for inquiry and report. The hearing occupied over 150 days and in a 953 page report, the referee found in favour of ABB on the grounds that:

• the letter of intent did not operate as an offer by Abigroup to ABB to perform the works, which ABB could accept by commencing the works;

• collection of the drawings by ABB on 20 February 1998 was not 'commencement of the works'; and

• ABB had not commenced the works by 20 February 1998 when (even if the letter of intent was an offer by Abigroup) ABB rejected the offer in its letter of 20 February confirming that various contractual issues remained to be resolved.

The report was subsequently adopted and Abigroup appealed against the decision to adopt the report. Abigroup's appeal was unsuccessful and the Supreme Court of New South Wales (Court of Appeal) agreed with the referee. Justice Giles gave the main judgment and as well as agreeing with the findings of the referee, also looked at the intention and the conduct of the parties after 20 February 1998. He found this conduct indicated that there was no contract on foot. For example, ABB made a payment claim for work to 30 June 1998. In a certificate dated 23 July 1998 Abigroup approved payment of $824,290.96 which contained the words 'notwithstanding that there is no contractual requirement to provide a payment certificate..' Justice Giles also found ABB's letter of 20 February to be indicative of the fact that no contract was agreed.

As there was found to be no contract on foot, ABB was successful in its quantum meruit claim and was entitled to judgment in the amount of $4,773,962.47.

These cases highlight the dangers of letters of intent for principals, contractors and subcontractors.

Different lessons can be learned from each of these cases depending on which side of the fence one sits. In terms of contractors, the issue of a letter of intent is often seen as positive. The contractor immediately is placed in a stronger bargaining position once he has mobilised to site and has commenced works. The contractor can adopt a firmer stance in negotiating the contractual terms as it is unlikely that the principal will withdraw the letter of intent, instruct the contractor to demobilise from the site and seek to negotiate with, and eventually appoint a replacement contractor.

When a limit on the principal's liability is included in the letter of intent (as in the Stenna case), the contractor should ensure it negotiates an extension, or has executed the contract before it incurs additional expenditure. As mentioned above the contractor's bargaining position will be strong, and this will avoid the contractor being unable to recover any additional expenditure it has incurred above the principal's maximum liability.

In terms of the principal, the letter generally should only authorise the contractor to undertake certain things and should not be a blanket authority to proceed with the works as a whole. This can either by done by way of a financial limit (as in the Stenna case) or by way of stating the activities the contractor is authorised to undertake under the letter. This will ensure the contractor retains an incentive to bargain reasonably as the contractor will not yet have a contract to execute the whole works.

The principal should always consider whether the letter of intent is intended to create a binding contract, for example, in circumstances where the letter of intent can be interpreted as an acceptance of the contractor's tender. If the letter of intent is not intended to create a formal binding contract the letter should be clear on this point, and the principal should ensure its subsequent actions are in accordance with this intention.

In conclusion, letters of intent can be something of a two edged sword. They are often required to ensure deadlines for completion may be met but they can result in disputes and litigation, especially where the building contract is never executed. Careful consideration of the purpose and the drafting of the letter will be required, and the parties should be aware that their subsequent conduct may also affect the determination of any dispute as to whether or not the contract has actually been entered into. Proper consideration of the issues highlighted above and a careful drafting of the letter itself will be essential.

James Williams' article was previously published in Carter Newell's Constructive Notes—April 2006. Reprinted with permission.
