

Your Contractual Questions Answered

Can A Letter Of Intent Be Construed As An Enforceable Contract?

By The Entrusty Group

Entrusty Group, a multi-disciplinary group of companies, of which, one of their specialisation is in project, commercial and contractual management, has been running a regular contractual questions and answers section for Master Builders members in the Master Builders Journal.

In this instalment of this series, Entrusty Group will provide the answer to another frequently asked question above.

Letters of Intent are a common feature in the construction and engineering industry such that it is a useful tool for both parties while negotiating a formal contract or agreement, allows one party to begin work on the basis of a Letter of Intent before the formal contract or agreement is concluded. In circumstances where Letters of Intent are utilised, time constraints often do not permit all the terms of the contract, design and costing to be finalised and concluded so that a formal contract exists between both parties before one party carry out work under the formal contract. A likely scenario is when it is known to the Purchaser that the materials to be supplied by the Seller require long lead time to deliver and the Purchaser by way of a Letter of Intent, instructs the Seller to place order for the materials in advance of and while a formal contract is being entered. Other scenarios where Letters of Intent are used are situations where the Purchaser requires the Seller to reserve for them the goods or services that may not be made available to the Purchaser if the Purchaser and Seller had followed through the usual process of negotiation of a formal contract or the Purchaser wants the Seller to place order for the goods

earlier so that manufacturing can start early to minimise any delay caused by the ordering of the goods under normal circumstances or the Employer in a construction project requires the Contractor to mobilise into the site, pending formal contract, to reduce any delay in commencement of work. In other words, the purpose of the Letter of Intent is to enable work to proceed, to circumvent the long lead times usually reserved for a particular part of the work, by providing an intention that a formal contract would be agreed and finalised at a later stage.

Letter of Intent – Enforceable or not?

Although the Letter of Intent's well meaning intended purpose is to avoid delay to the work, it has one serious and fundamental flaw – The Letter of Intent is neither an offer nor a contract. In the event that there would not be a formal contract to be agreed and finalised between both parties making the Letter of Intent the sole document to bind the parties, there runs a risk that parties have to rely on the wordings of the Letter of Intent to fight for their respective rights. A formal contract requires agreement

by the parties on all the terms and condition that is vital for the particular project or purchase and is recognised under Common Law as a legally binding document where parties have the intention to be legally bound. Letters of Intent do not have that capacity to be a legally binding document as the wordings and statements more often than not are incomplete and vague. In most cases, a Letter of Intent is binding on neither party and has no contractual effect. So in that case, would the answer to the question whether the Letter of Intent is enforceable contract is an affirmative No?

Before we delve into answering the question, let us explore and understand the types of Letters of Intent which generally falls into two types i.e. the traditional Letter of Intent and the "If" Contract. The traditional Letter of Intent basically contains instructions by the Employer for particular works to be carried out by the Contractor but typically the statements in such Letters are vague and uncertain as such do not have the contractual obligations to bind parties. The "If" Contract contains not only instructions to the Contractor to carry out work but also states that *if*

the Contractor carries out the work, the Employer undertakes to pay the Contractor for the work. This type of Letter of Intent is more defined and robust than the traditional type in that certain fundamental terms and condition such as pricing, scope of work and commencement and completion dates are agreed between parties as well as, it gives some financial assurance to the Contractor whenever work is being carried out and the Contractor does so on a contractual basis.

With the types of Letter of Intent already described, the key as to whether a Letter of Intent can be construed as an enforceable contract lies with the wordings and statements contained therein. As there are no hard and fast rules in drafting a Letter of Intent, different Letters written in various ways often come up with different results when parties bring their disputes to the Court of Law for adjudication. Therefore, it is pertinent that the Contractor or the party who is carrying out the work and therefore, holds the greater financial risk in the event disputing parties have to rely on the Letter of Intent in the absence of a formal contract, understand his entitlement as stipulated in the Letter of Intent before agreeing to execute the works.

Standard Forms of Contract and Malaysia Contracts Act 1950

All standard forms of Contract in Malaysia do not specifically mention the rights and entitlement of the Contractor under Letter of Intent in the event of dispute where no formal contract was agreed and finalised although it does allow for principles of quantum meruit to be claimed by the Contractor. This is obvious because Standard Forms of Contract deal with rights and obligations of the Contractor under Contract that have already been



Partly completed building

agreed and formalised per se and the Letter of Intent is a precursor document to enable the Contractor to proceed with the work to avoid delay not amounting to a formal Contract as mentioned previously.

As for Malaysia Contracts Act 1950, again as described earlier, fundamental principles such as pricing, scope of work and commencement and completion dates must be worded in the Letter of Intent so that some sort of Contract can take shape in the Letter of Intent to be construed as an enforceable contract and therefore, the Contractor can claim and be paid compensation on *quantum meruit* for carrying out the work in the absence of a formal contract. Now let us look at some case laws to shed light into when a Letter of Intent can be construed as an enforceable contract and when it is not.

Case Law – Where a Letter of Intent is binding on neither party

Turriff Construction Ltd. vs Regalia Knitting Mills Ltd. (1971)

A Letter of Intent was issued by Regalia Knitting to Turriff Construction to urgently commence construction of a factory with the

intention that Regalia award a contract to Turriff subject to an agreement and acceptable contract. Turriff agreed to commence work provided that Regalia undertake liability for its work done. The Court held that Regalia was still liable to Turriff because a subsequent contract was made in that Regalia had agreed to undertake liability for Turriff's work done and it could not be construed as part of the subject to an agreement of an acceptable contract as stated in the Letter of Intent pending the acceptable contract. The Letter of Intent was merely an expression of an intention to enter into a acceptable contract and therefore, not a binding contract but the subsequent contract which Regalia agreed to undertake was a binding one.

British Steel Corporation v Cleveland Bridge and Engineering Co. (1981)

British Steel manufactured and supplied cast steel nodes to Cleveland Bridge based on a Letter of Intent. The parties then negotiated on the terms and condition of the contract but were unable to agree on the specifications and the price of the nodes and therefore, no formal contract could be agreed. Meanwhile, British Steel continued

to manufacture and supply the cast steel nodes to Cleveland Bridge without a formal contract. Complications arose when British Steel could not meet certain delivery schedule and there were delays in delivery of the cast steel nodes. British Steel claimed as *quantum meruit* the amount for the cast steel nodes it had delivered while Cleveland Bridge counter-claimed damages for breach of contract for late delivery and out of sequence. The learned Judge found in favour of British Steel that there was no contract between parties since parties were still in negotiation and therefore, without a contract there could not be damages out of a breach of contract.

Kitson Ltd vs Balfour Beatty (1991)

In this case, after submitting for a tender and revising their pricing after changes were made to the tender, Kitson commenced work after a Letter of Intent was issued by Balfour Beatty so that Kitson can start the work early pending acceptance of the revised tender by Balfour Beatty. Several months later, Balfour Beatty wrote to Kitson to accept the revised tender but the documents enclosing the acceptance letter contained changes made after the Letter of Intent was issued and as such was not the same as contained in the Letter of Intent, which Kitson promptly refuse to accept. The matter was taken to Court when a dispute arose which Kitson contended there was no binding contract but Balfour Beatty contended otherwise when the Letter of Intent was issued and accepted by Kitson. The learned Judge held that there is no binding contract between the two when both parties agreed that the Letter of Intent was issued solely for the purpose that work can commence and an eventual contract would be made.

Case Law – Where a Letter of Intent forms an “If” Contract

Monk Construction Ltd. vs Norwich Union Life Insurance Society CA (1992)

Monk carried out work based on a Letter of Intent issued by Norwich which stated that the maximum expenditure for mobilisation and ordering of materials was limited to £100,000.00 and if a formal contract could not be concluded, Monk’s entitlement would be limited to proven costs. No contract was entered but Monk went on to carry out work and made a £4 million claim as *quantum meruit*. Norwich argued that an “If” Contract was entered and Monk’s entitlement was not based on *quantum meruit* but proven costs as stipulated in the Letter of Intent. The Judge in the Court of Appeal held that Monk was entitled to the claim based on *quantum meruit* as the Letter of Intent did not amount to an “If” Contract because proven cost was limited to mobilisation and ordering of materials but not for the execution of the works that Monk had carried out. Therefore, Monk was entitled to their claim based on *quantum meruit*.

J Jarvis & Sons PLC vs Galliard Homes Ltd (1999)

In another case of an “If” Contract, the Court of Appeal agreed with Jarvis that the words in the Letter of Intent issued by Galliard, “*in the event that we do not enter into a formal contract with through no fault of Jarvis Interiors, you will be reimbursed all fair and reasonable costs incurred and these will be assessed on a quantum meruit basis.*”, held a basis for Jarvis to claim for works on *quantum meruit* as opposed to Galliard’s contention that a gentlemen’s agreement was agreed between the two parties at

a certain amount after completion of the works.

Mowlem plc vs Stena Line Ports Ltd (2004)

In this case, Mowlem carried out works under a series of Letters of Intent issued by Stena, each with maximum expenditure caps, the final maximum cap in the final Letter of Intent being £10 million. However, Mowlem continued to carry out works exceeding the maximum cap of £10 million although both parties agreed that if Mowlem carried out work under each Letter of Intent from Stena, it constituted to an offer to enter into a contract. The dispute was whether Mowlem was entitled to be paid more than £10 million for work done as *quantum meruit* or whether Stena’s £ 10 million maximum cap applied. The learned Judge found in favour of Stena’s arguments because the maximum cap in the Letter of Intent clearly stated that Stena was only obliged to pay for work done up to a maximum amount of £10 million and imposes no obligation for Mowlem to carry out work more than the maximum cap. As such, Mowlem failed in their claim for *quantum meruit*.

Allen Wilson Shopfitters vs Anthony Buckingham (2005)

Allen Wilson carried out extensive refurbishment works at Anthony Buckingham’s house pursuant to a Letter of Intent which stated among other terms “*works to be carried out under the terms and conditions of the JCT 1998 Private Without Quantities 1998 edition.*” and “*In the event that no formal Contract is entered into then the terms of this letter will apply to the whole of the works carried out by you. The employer will pay for you any work so completed in accordance with the payment provisions of the Contract...*”. No formal contract was entered

and when the Employer failed to pay, the Contractor obtained an adjudication decision in its favour which the Employer challenged the enforcement of the decision on the basis that there was no written contract. The learned Judge found that there was a contract pursuant to the Letter of Intent when the Contractor agreed to carry out works for the prices set out in and also held that all terms of the JCT 1998 edition, including adjudication were incorporated into the contract.

ERDC Group Ltd vs Brunel University (2006)

In this case, the Court found that the parties intended to enter into a legal relation and that each Letter of Intent issued by Brunel was an offer which ERDC accepted by commencing work which in turn, resulted in a contract which JCT valuation rules and ERDC's tender rates applied for each Letter of Intent. However, for works carried out after the expiry of the last Letter of Intent, there was no contract and ERDC was entitled to *quantum meruit* payments assessed by reference to ERDC's tender rates. Brunel was not entitled to counterclaims since the defective works was not carried out pursuant to a contract.

Case Law – Letter of Intent on the Local Front

Ayer Itam Tin Dredging Malaysia Berhad vs YC Chin Enterprise Sdn Bhd (1994)

The Contractor, based on a letter written on September 1984 by the Employer, proceeded to commence work on the project site, appointed professionals and arranged project financing while negotiating with the Employer to formalise the contract. However a dispute arose and in the absence of a contract, the Employer contended that there was no binding contract and the Letter was

part of an agreement to agree to a future agreement. The Contractor, on the other hand, stated that all terms and conditions were already agreed between parties, only to be formalised into a contract. The learned Judge in the Supreme Court held that arrangement made 'subject to contract' or 'subject to the preparation and approval of a formal contract' and similar terms would mean that the parties were still in negotiations and did not intend to be bound until a formal contract was agreed. However, 'subject to contract clause' terms would not prevent the formation of a contract in exceptional circumstances. He found that with several essential matters remained to be settled between the parties, the Letter is not a binding contract but merely a record of terms agreed by parties as a basis for contract negotiation. The Contractor was awarded a claim on *quantum meruit* subject to a maximum limit.

Khaw Kim Chua & Anor vs Dayani Sdn Bhd (2005)

This was a case where the Defendant agreed to sell completed shop houses to Plaintiff, all of whom were squatters of the land which the Defendant was developing, if the Plaintiff vacated the Land without compensation. A memorandum of

understanding (MOU) was entered between parties. Although the Plaintiff accepted the offer of RM178,000.00 for the shop house, no Sales and Purchase Agreement was executed as required by the MOU. The Plaintiff was forced to leave the temporary long shop house built by the Defendant after it was demolished and by a civil suit, the Plaintiff sought an order against the Defendant for specific performance of the MOU and damages for compensation. The High Court held the judgement in favour of the Plaintiff because the Defendant had benefited from the MOU when the Plaintiff agreed to vacate the land without compensation and with the subsequent acts by the Defendant for the Plaintiff, the Court found that the MOU was a binding contract although no Sales and Purchase Agreement was entered between the two.

Lam Hong Hardware Co. Sdn Bhd vs Incacon Sdn Bhd (2006)

The Judge held that the Letter of Intent was not a contract as it did not contain terms that would have existed in a formal contract such as pricing, rates and payment method for this case where Lam Hong had supplied materials to Incacon based on a Letter of Intent which Lam Hong had taken the matter to Court



Construction project site

when Incacon did not make payment for the supplied materials.

CONCLUSION

The practice of using Letters of Intent in the construction and engineering industry is still popular because Employers/Purchasers can ensure that work can commence early by the Contractor/Seller while the tedious time consuming activity of negotiation and finalising the formal contract can be carried out concurrently. Whether it is reasonable to the Employer/Purchaser to allow work to proceed or the Contractor/Seller to continue with the work depends on the situation, terms and condition of the Letters as well as the amount of risk these Letters pose to the Employer/Purchaser as complications would arise in the event of dispute between parties without a formal contract because these Letters create uncertainty as an enforceable contract.

In the event that no formal contract be entered between parties then the precise wordings in the Letter of Intent becomes important. Whether a Letter of Intent can be construed as an enforceable contract depends heavily on these precise wordings written by the Employer/Purchaser. As previous cases have demonstrated, the Employer/Purchaser possesses a greater risk of failing in their case than the Contractor/Seller if the Letters offer statements that are uncertain and ambiguous in the contractual obligations of parties. Therefore, in the event where a Letter of Intent is used, its terms should be as clear as possible so that both parties can understand the contractual boundaries in which the Letter will operate. If possible, the Letter should be structured in such a way that it forms the basis of a formal contract that would be concluded between parties while maintaining an appropriate balance of risk for both parties. **MBJ**

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In the next issue of the MBAM journal the article will answer the question on **'Must the Contractor submit his Interim Payment Claim before the Superintending Officer certifies for payment?'**



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For further details, please visit website: www.entrust.com. or contact HT Ong at 22-1& 2 Jalan 2/109E, Desa Business Park, Taman Desa, 58100 Kuala Lumpur, Malaysia. Tel: 6(03)-7982 2123 Fax: 6(03)-7982 3122 Email: enquiry@entrust.com.my.

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