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The Dangers of Letters of Intent – Be clear about your intentions

Thinking of using a letter of intent? If so, proceed at your own peril – whilst the potential pitfalls of letters of intent should, by now, be well known to employers and contractors, recent case law has once again illuminated the dangers of proceeding using a letter of intent in the absence of a formal contract being in place.

It is clear that construction and development projects can involve many technical and practical elements which means the parties frequently spend the time before works are commenced or materials ordered focused on ensuring that the wide-ranging technical and practical aspects of the project are agreed. The parties often come under pressure to commence works or preparations for the works as soon as possible and it is not unusual for the parties still to be concluding contract negotiations when the contractor needs to start to procure materials, commence site preparations or even start the works. In these circumstances, in the absence of an agreed construction or development contract, the temptation of the parties is to use a letter of intent.

The absence of a clear, comprehensive and concluded contract often leads to disputes over the scope of work and claims for further payment and/or time. This has been brought into sharp focus by a recent decision in the Technology and Construction Court where the works were delayed and the employer could not claim liquidated damages for delay from the contractor because the letter(s) of intent did not contain liquidated damages provisions and the project manager had failed to procure the execution of a formal building contract.

In Trustees of Ampleforth Abbey Trust v Turner and Townsend Project Management Limited 2012 EWHC 2137 (TCC), Turner & Townsend Project Management (TTPM) were employed as project manager by the Trust on a project to provide new boarding accommodation for the Ampleforth College. TTPM allowed the contractor to start work under a letter of intent because key issues, including the contract sum, had not finally been agreed and there was an urgency since the accommodation was required by students for the beginning of the academic year. TTPM allowed the whole project to proceed under letters of intent. TTPM drafted the letters of intent, all of which stated that neither party intended to be bound by the full contract until it was executed by both parties. TTPM continually issued further letters of intent and the building contract was not executed until long after the works were completed.

The works were satisfactory as to quality but were completed significantly later than had been envisaged - later than the start of the academic term and well after the original completion date. This resulted in the students having no accommodation to move in to and the Trust incurring significant costs in having to find suitable alternative accommodation. Building contracts have provisions for liquidated damages to cater for the consequences of such a delay and in this instance the draft contract attached to the first letter of intent put the liquidated damages at £50,000 for each week of delay. However, in this case the letters of intent did not incorporate the draft terms; they specifically stated that neither party would be bound by their terms until execution of the formal contract. The Trust brought a negligence claim against TTPM for lost liquidated damages, alleging that it was TTPM's obligation to procure and settle the formal building contract and their failure to do so had cost the Trust a sizeable loss.

The court held that TTPM were liable and they had failed to exercise sufficient focus on the matters holding up execution of the contract or to exert sufficient pressure on the contractor to do so. TTPM owed the Trust a duty to exercise reasonable care and skill for the purpose of procuring from the Contractor an executed building contract and that it was in breach of that duty. This breach had caused the Trust to suffer loss in respect of liquidated damages.

Affirming previous decisions of the court, the judge in this instance decided that as "co-ordinator and guardian of the client's interests", TTPM had failed (i) to take the steps reasonably required of a competent project manager; (ii) to adequately to focus on the matters that remained outstanding before a contract could be signed; (iii) to work urgently to resolve those matters one by one; (iv) to advise the Trust of the need to ensure that a contract was signed; and (v) to bring proper pressure on the contractor to finalise the contract. The judge stated that efforts to finalise the contractual arrangements are of central importance; the execution of a contract is to be seen not as a mere aspiration or "a dispensable luxury" but rather as fundamental.

The court held that TTPM's breach of their duty of care to the Trust caused the Trust loss. If there had been no such breach of duty and TTPM properly advised the Trust, there was a "real and substantial chance" that the contractor would have executed a contract which had a provision for liquidated damages. TTPM were operating under the illusion that the Trust was entitled to liquidated damages, notwithstanding that the building contract had not been executed.

TTPM sought to rely on a clause in their appointment limiting their liability to either the fees paid to them or £1 million, whichever is the lesser. The court held that TTPM could not rely on this limitation of liability in its appointment because the provision contravened section 3 of the Unfair Contract Terms Act 1977 and the clause, which would have limited liability to under £200,000 was "draconian" when considered against the requirement to maintain professional indemnity insurance at a level of £10 million; if the limitation was upheld the insurance would effectively be "rendered illusory". The limitation was therefore unenforceable.

This decision is another reminder of why it is never in the parties' interests for works to be carried out under a letter of intent however close to agreement the parties are and however desperate the employer is to proceed. A letter of intent is, invariably, never adequate to protect the respective parties' interests given its specific, restricted and temporary purpose. There is a lesson here for all professionals and consultants, not just project managers, who are contracted by employers to complete the contractual documents for development projects. This case demonstrates the importance of such professionals ensuring that contractual arrangements are completed and are not forgotten about once the building works are actually commenced. There is another significant consequence of this decision for professional consultants of all disciplines that adopt the practice of limiting liability to the fee, or multiples of it, at figures less than the insurance amount – such a limitation may be unreasonable if it is far below the amount of professional indemnity insurance required under the professional appointment.

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