
Chapter 1

Letters of Intent

Usually, a letter of intent merely expresses an intention to enter into a contract in the future, and creates no contractual liability. It is a question upon the facts of each case whether a letter of intent gives rise to any and, if so, what liability.

British Steel Corporation v. Cleveland Bridge & Engineering Co Ltd

QUEEN'S BENCH DIVISION
(1981) 24 BLR 94

CBE were involved in the construction of a bank in Saudi Arabia, and needed to be supplied with cast steel nodes, for which supply they negotiated with BSC. On 21 February 1979, CBE sent the following letter of intent to BSC:

'Samma Bank: Damman

We are pleased to advise you that it is [our] intention to enter into a subcontract with your company, for the supply and delivery of the steel castings which form the roof nodes on this project . . . We understand that you are already in possession of a complete set of our node detail drawings and we request that you proceed immediately with the works pending the preparation and issuing to you of the official form of subcontract.'

Consequent upon this letter BSC started work. On 27 February 1979 CBE sent a telex to BSC listing the sequence in which they required the nodes to be delivered, this being the first intimation that CBE required the nodes to be manufactured in a particular order. Despite the problems this caused, BSC continued to manufacture the nodes.

CBE did not send 'the official form of sub-contract' to BSC, nor did the parties agree on price or delivery dates. Ultimately, CBE did not pay BSC for the delivered nodes.

BSC claimed £229,832.70 from CBE as the price of the nodes, the claim being based in contract and alternatively upon a quantum meruit. CBE admitted that the goods were sold and delivered to them, and admitted liability in part. This admission was subject to a plea of set-off totalling £867,735.68, which CBE counter-claimed on the ground that BSC, in breach of contract, delivered the nodes late and out of sequence.

BSC's primary contention was that they were entitled to be paid on a quantum meruit because, if there was no binding contract between the parties, there was no legal basis for CBE's counter-claim. CBE argued that the agreement between the parties was comprised in the letter of 21 February, the telex concerning the delivery sequence, and BSC's conduct in proceeding with the manufacture of the nodes.

Held: No contract had come into existence between the parties on the basis of the letter of intent and BSC's performance, but BSC were entitled to be paid upon a quantum meruit.

ROBERT GOFF J: [The] question whether in a case such as the present any contract has come into existence must depend on a true construction of the relevant communications which have passed between the parties, and the effect (if any) of their actions pursuant to those communications. There can be no hard and fast answer to the question whether a letter of intent will give rise to a binding agreement; everything must depend on the circumstances of the particular case. In most cases where work is done pursuant to a request contained in a letter of intent, it will not matter whether a contract did or did not come into existence; because if the party who has acted on the request is simply claiming payment, his claim will usually be based upon a quantum meruit, and it will make no difference whether that claim is contractual or quasi-contractual. Of course, a quantum meruit claim (like the old actions for money had and received, and for money paid) straddles the boundaries of what we now call contract and restitution; so the mere framing of a claim as a quantum meruit claim, or a claim for a reasonable sum, does not assist in classifying the claim as contractual or quasi-contractual. But where, as here, one party is seeking to claim damages for breach of contract, the question whether any contract came into existence is of crucial importance.

As a matter of analysis the contract (if any) which may come into existence following a letter of intent may take one of two forms – either there may be an ordinary executory contract, under which each party assumes reciprocal obligations to the other; or there may be what is sometimes called an 'if' contract, i.e. a contract under which A requests B to carry out a certain performance and promises B that, if he does so, he will receive a certain performance in return, usually remuneration for his performance. The latter transaction is really no more than a standing offer which, if acted upon before it lapses or is lawfully withdrawn, will result in a binding contract.

The former type of contract was held to exist by Judge Fay in *Turriff Construction Ltd v. Regalia Knitting Mills Ltd* (1971), and it is the type of contract for which [CBE] contended in the present case. Of course, as I have already said, everything must depend on the facts of the particular case; but certainly, on the facts of the present case – and, as I imagine, on the facts of most cases – this must be a very difficult submission to maintain. It is only necessary to look at the terms of CBE's letter of intent in the present case to appreciate the difficulties. In that letter, the request to BSC to proceed immediately with the work was stated to be 'pending the preparation and issuing to you of the official form of sub-contract', being a subcontract which was plainly in a state of negotiation, not least on the issues of price, delivery dates, and the applicable terms and conditions. In these circumstances, it is very difficult to see how BSC, by starting work, bound themselves to any contractual performance. No doubt it was envisaged by CBE at the time they sent the letter that negotiations had reached an advanced stage, and that a formal contract would soon be signed; but since the parties were still in a state of negotiation, it is impossible to say with any degree of certainty what the material terms of the contract would be. I find myself quite unable to conclude that, by starting

work in these circumstances, BSC bound themselves to complete the work. In the course of argument, I put to [counsel] the question whether BSC were free at any time, after starting work, to cease work; his submission was that they were not free to do so, even if negotiations on the terms of the formal contract broke down completely. I find this submission to be so repugnant to common sense and the commercial realities that I am unable to accept it. It is perhaps revealing that, on 4 April 1979, BSC did indeed state that they were not prepared to proceed with the contract until they had an agreed specification – a reaction which, in my judgment, reflected not only the commercial, but also the legal, realities of the situation.

I therefore reject CBE's submission that a binding executory contract came into existence in this case. There remains the question whether, by reason of BSC carrying out work pursuant to the request contained in CBE's letter of intent, there came into existence a contract by virtue of which BSC were entitled to claim reasonable remuneration; i.e., whether there was an 'if' contract of the kind I have described. In the course of argument, I was attracted by this alternative – really on the basis that, not only was it analytically possible, but also that it could provide a vehicle for certain contractual obligations of BSC concerning their performance – e.g., implied terms as to the quality of goods supplied by them. But the more I have considered the case, the less attractive I have found this alternative. The real difficulty is to be found in the factual matrix of the transaction, and in particular the fact that the work was being done pending a formal sub-contract the terms of which were still in a state of negotiation. It is, of course, a notorious fact that, when a contract is made for the supply of goods on a scale and in circumstances such as the present, it will in all probability be subject to standard terms, usually the standard terms of the supplier. Such standard terms will frequently legislate, not only for the liability of the seller for defects, but also for the damages (if any) for which the seller will be liable in the event not only of defects in the goods but also of late delivery. It is a commonplace that a seller of goods may exclude liability for consequential loss, and may agree liquidated damages for delay. In the present case, an unresolved dispute broke out between the parties on the question whether CBE's or BSC's standard terms were to apply – the former providing no limit to the seller's liability for delay, and the latter excluding such liability altogether. Accordingly when in a case such as the present the parties are still in a state of negotiation, it is impossible to predicate what liability (if any) will be assumed by the seller, e.g., for defective goods or late delivery, if a formal contract should be entered into. In these circumstances, if the buyer asks the seller to commence work 'pending' the parties entering into a formal contract, it is difficult to infer from the seller acting upon that request that he is assuming any responsibility for his performance, except such responsibility as will rest upon him under the terms of the contract which both parties confidently anticipate they will shortly enter into. It would be an extraordinary result if, by acting on such a request in such circumstances, the seller were to assume an unlimited liability for his contractual performance, when he would never assume such liability under any contract which he entered into.

For these reasons, I reject the solution of the 'if' contract. In my judgment, the true analysis of the situation is simply this. Both parties confidently expected a formal contract to eventuate. In these circumstances, to expedite performance under that anticipated contract, one requested the other to commence the contract work, and the other complied with that request. If thereafter – as anticipated – a contract was entered into, the work done as requested will be treated as having been performed under that contract; if, contrary to their expectation, no contract was entered into, then the performance of the work is not referable to any contract of which the terms can be ascertained, and the law simply imposes an obligation on the party who made the request to pay a reasonable sum for such work as has been done pursuant to that request, such an obligation sounding in quasi-contract or, as we now say, in restitution. Consistently with that solution, the party making the request may find himself liable to pay for work which

he would not have had to pay for as such if the anticipated contract had come into existence, e.g. preparatory work which will, if the contract is made, be allowed for in the price of the finished work: cf. *William Lacey (Hounslow) Ltd v. Davis* (1957). This solution moreover accords with authority, e.g. the decision in *Lacey v. Davis* (above); the decision of the Court of Appeal in the unreported case of *Sanders & Forster Ltd v. A. Monk & Co. Ltd* (1980), though that decision rested in part on a concession; and the crisp dictum of Parker J in *O.T.M. Ltd v. Hydranautics* (1981), when he said of a letter of intent that ‘its only effect would be to enable the defendants to recover on a quantum meruit for work done pursuant to the direction’ contained in the letter. I only wish to add to this part of my judgment the footnote that, even if I had concluded that in the circumstances of the present case there was a contract between the parties and that that contract was of the kind I have described as an ‘if’ contract, then I would still have concluded that there was no obligation under that contract on the part of BSC to continue with or complete the contract work, and therefore no obligation on their part to complete the work within a reasonable time. However, my conclusion in the present case is that the parties never entered into any contract at all.

In the course of his argument, [Counsel] submitted that, in a contract of this kind, the price is always an essential term in the sense that, if it is not agreed, no contract can come into existence. [He] relied upon a dictum of Lord Denning MR in *Courtney & Fairbairn Ltd v. Tolaini Brothers (Hotels) Ltd* (1975), to the effect that the price in a building contract is of fundamental importance. I do not however read the Master of the Rolls’ dictum as stating that in every building contract the price is invariably an essential term, particularly as he expressly referred to the substantial size of the contract then before the Court. No doubt in the vast majority of business transactions, particularly those of substantial size, the price will indeed be an essential term, but in the final analysis it must be a question of construction of the particular transaction whether it is so. This is plain from the familiar trilogy of cases – *May & Butcher Ltd v. The King* (1929); *W.N. Hillas and Co. Ltd v. Arcos Ltd* (1932); and *Foley v. Classique Coaches Ltd* (1934) – which show that no hard and fast rule can be laid down but that the question in each case is whether, on a true construction of the relevant transaction, it was consistent with the intention of the parties that even though no price had been agreed a reasonable price should be paid. In the present case, however, I have no doubt whatsoever that, consistently with the view expressed by the Master of the Rolls in *Courtney v. Tolaini Brothers*, the price was indeed an essential term, upon which (among other essential terms) no final agreement was ever reached.

It follows that BSC are entitled to succeed on their claim; and that CBE’s set-off and counterclaim must fail.

RTS Flexible Systems v Molkerei Alois Müller GmbH & Co KG

SUPREME COURT

(2010) 129 Con LR 1; [2010] UKSC 14

The defendant (Müller) was a leading dairy product supplier. At its premises in Market Drayton it produced different brands of Yoghurt and dairy rice products. The claimant (RTS) specialised in the supply of automated machines for packaging and product handling in the foods industry. There were negotiations between the parties from 2000 about plans to automate the process of packaging multi-packs of yoghurt. In April 2004 RTS provided quotation A and subsequently ten further quotations (down to quotation K), the later ones all in a format requested by Müller.

The work which RTS undertook was the design, manufacture, assembly, works testing, delivery, installation and commissioning at Müller's factory at Market Drayton of equipment described as line 1 and line 2. Müller were to supply the packaging equipment for the lines.

On 13 January 2005 RTS issued its quotation I. It indicated that it was prepared to enter into a contract based on MF/1 conditions and expressed concern about the time it would take to reach agreement on the contract conditions. On 13 February RTS were told that they had been awarded the contract.

On 15 February RTS issued quotation J. This specified a fixed price of £1,682,000. It provided for liquidated damages for delay of 0.5% of total contract value for a delay up to five weeks. There were many other detailed conditions and appendices.

On 27 February Müller sent RTS a letter of intent agreeing the contract price, instructing a start to work and providing for a full contract based on Müller's amended version of MF/1 within four weeks. Prior to completion of the contract only Müller were to have the right to terminate. On termination Müller were to be liable for reasonable out-of-pocket expenses but not for loss of profit.

On 1 March RTS wrote to Müller confirming that they had started work and raising points about the letter of intent. Negotiations as to the terms commenced. In April the four-week period for negotiating the contract was extended by agreement until 16 May and later until 27 May.

On 16 March Müller sent RTS a first draft of MF/1 amended and including provisions as to liquidated damages and limitation on RTS's liability. There were further exchanges and by 25 May the parties were agreed as to the wording of the amended MF/1 conditions save for the definition of force majeure which was agreed by an exchange of e-mails on 5 July. Meanwhile there were negotiations as to the schedules of which there were 17. No written contract was ever signed. Müller paid RTS 30% of £1,682,000 on about 28 April 2005, a further 30% in September 2005 and 10% in January 2006.

A dispute arose. Both parties argued before Christopher Clarke J as their primary position that there was a contract. Christopher Clarke J held that there was a contract but that it did not include the final draft version of the MF/1 terms. Before the Court of Appeal RTS argued that there was no contract. The Court of Appeal held that it was open to RTS so to argue and that since the parties were negotiating around the MF/1 conditions clause 48 of those made it clear that for a contract on those conditions to come into existence there had to be an agreement in writing. It followed that there was no contract.

Müller appealed.

Held: (allowing the appeal) – an objective analysis of the behaviour of the parties led to the conclusion that:

(1) they intended their relationship to be contractually binding and (2) after the expiry of the letter of intent contract, they intended to be bound by the terms they had agreed on or before 5 July as subsequently varied on 25 August, except (3) that the agreement (though incorporating the agreed versions of the MF/1 conditions) did not

include cl 48 and was not therefore dependent on the completion of a written contract.

LORD CLARKE SCJ:

The first point remains. Had the parties agreed to be bound by the agreed terms without the necessity of a formal written contract or, put another way, had they agreed to waive that requirement and thus cl 48? We have reached the conclusion that they had. The circumstances point to the fact that there was a binding agreement and that it was not on the limited terms held by the judge. The price had been agreed, a significant amount of work had been carried out, agreement had been reached on 5 July and the subsequent agreement to vary the contract so that RTS agreed to provide line 1 before line 2 was reached without any suggestion that the variation was agreed subject to contract. The clear inference is that the parties had agreed to waive the subject to contract clause, viz cl 48. Any other conclusion makes no commercial sense. RTS could surely not have refused to perform the contract as varied pending a formal contract being signed and exchanged. Nobody suggested that it could and, of course, it did not. If one applies the standard of the reasonable, honest businessman suggested by Steyn LJ, we conclude that, whether he was an RTS man or a Müller man, he would have concluded that the parties intended that the work should be carried out for the agreed price on the agreed terms, including the terms as varied by the agreement of 25 August, without the necessity for a formal written agreement, which had been overtaken by events.