

Letters of intent - Why it pays to be prudent

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Letters of intent are widely used in the building and construction industry as a mechanism to secure long-lead items and get works and services underway while allowing the parties to continue to negotiate the precise contract terms. The recent High Court judgment in *Electrix Limited v The Fletcher Construction Company Limited* is a useful reminder of the real risks in that approach.

Facts

Fletcher Construction, as main contractor for the Ministry of Justice's Christchurch Justice and Emergency Services Precinct project, confirmed Electrix as its preferred electrical works sub-contractor. Fletcher Construction, considering that the electrical works package was time critical, provided Electrix with an initial letter of intent, authorising Electrix to commence works and services and incur costs up to a pre-specified value. As sometimes happens, the parties remained apart on the precise contract terms and the letter of intent was revised and reissued a number of times through the term of the electrical works package. In total, there were nine different letters of intent, with a total authorised value limit of c. \$14m.

Electrix submitted a total of forty-two payment claims against the nine letters of intent, for a combined amount of c. \$28m. Fletcher Construction paid Electrix c. \$21m for the subcontracted works and disputed the c. \$7m balance. In addition, Fletcher Construction sought a further c. \$7m reimbursement of sums it considered that it had overpaid given the various authorisations set out in the letters of intent.

Decision

The High Court found in favour of Electrix and ordered Fletcher Construction to pay to Electrix the c. \$7m balance plus GST and interest.

Central to this decision is the High Court's finding that there was no contract between Fletcher Construction and Electrix. Justice Palmer noted that, while Fletcher Construction and Electrix expected that they would be able to reach agreement on a contract, they never did and that, on the evidence considered:

"Fletcher Construction and Electrix did not intend to be bound by a particular agreement at any point and did not agree on the core essential terms for the provision of the services."

On the basis that there was no contract between Fletcher Construction and Electrix, the High Court held that Fletcher Construction was required to pay to Electrix the reasonable costs of the services under the common law doctrine of **quantum meruit**.

Practical application

The decision reinforces the principle that parties wishing to secure long lead items or procure works and services under a letter of intent should do so with extreme caution. Parties considering entering into a letter of intent as a result of not being able to agree contract terms, should ask themselves why they are unable to agree contractual terms. If the reason the parties are unable to agree contractual terms is because there are material unresolved issues that exist between them (legal, commercial, technical or otherwise), then a letter of intent will not resolve those differences while likely creating additional risk and complexity.

If the parties agree that a letter of intent is the only way forward then, generally speaking, it is prudent for such a letter to be prepared on the basis that a formal contract may never be finalised. This approach means that the parties would:

- Clearly define the matters unique to the letter of intent (in particular, the parties, the scope of the works and services authorised, price or payment limits, any start and 'drop-dead' dates)
- Identify and incorporate as many of the key and undisputed items from the main contract (in particular, payment provisions (including GST), works and service standards, insurance, limits on liability and governing law)
- Identify and detail the matters to be resolved before the formal contract can be entered into

- Record that the parties intend to be immediately bound by the letter of intent
- Provide for what is to happen if:
 - the formal contract is entered into (ie that the works and services performed and any payments made under the letter of intent will be 'wrapped' into the contract)
 - the formal contract is never finalised and entered into (ie termination and procedures on termination or possibly referral to dispute resolution for the outstanding matters).

Importantly, once the letter of intent is in place, the parties should not stop working towards agreeing the formal contract!

Quantum meruit – “the amount deserved”

The judgment is also useful in its discussion of the law of non-contractual **quantum meruit**, and the proper assessment of any claim under this doctrine. The High Court noted that the objective of the New Zealand law of non-contractual **quantum meruit** is “not confined only to dispossessing those who have been unjustly enriched but can also extend to providing redress for those who have been unjustly impoverished”.

In line with this statement, the High Court considered that in any assessment, the “reasonable cost of the services actually provided” was a better starting point than simply considering the “market value of the services that could have been used to undertake the works”. This was a particularly relevant consideration in this case as Electrix's evidence was that, due to poor project management by Fletcher Construction, it was required to re-perform significant elements of the works and services. This resulted in a material difference between the cost of the works and services actually performed by Electrix and the final value of the works and services provided.

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