Are Letters of Intent Legally Enforceable?

By: Bill Preston

Letters of Intent are a conundrum! Sometimes they are enforceable as a contract, and sometimes they are not! It really comes down to a question of legal intent: whether a judge/arbiter, after reading the words used in the Letter and considering the objective circumstances at and following the delivery of the Letter, would conclude that both the sender and the recipient intended it to be legally binding. The problem is that sometimes the construction industry's usual purpose for a Letter of Intent is to just notify a builder/supplier that they should start making preparations because they probably will get the award after possible future negotiations; and then sometimes the industry's purpose is to announce the award of the construction contract found either in the front-end documents or in the documentation which they usually used for like projects in the past. I'll review a recent Ontario decision in *Mason Homes* v. *Oshawa Group* to try to explain what judges/arbiters usually do to make their decision. In this case, it cost Oshawa Group $4 million because, while it felt that the Letter of Intent was not a binding contract, the judge ruled otherwise.

In 1989 Mason Homes was a would-be developer of a 95,000 ft^2 retail shopping plaza in Barrie, Ontario, which needed a 30,000 ft^2 anchor tenant. While, Oshawa Group was a large foot retailer looking for a site for either a 36,000 ft^2 Food City, or a 20,000 ft^2 IGA food store. After three months in negotiations, they both signed a Letter of Intent, the salient features of which were:

1. Mason Homes would construct a 105,000 ft^2 retail and office plaza in accordance with a then existing preliminary site plan allocating 36,000 ft^2 for a Food City.

2. Mason Homes would pay for consultants to, with all reasonable efforts by both parties, prepare drawings and specifications of the Food City space to the satisfaction of Oshawa Group.

3. Using Oshawa Group's existing construction specifications and drawings from other Food City locations, they agreed on a construction price recoverable by rental payments and a detailed escalation clause to cover off the event that Oshawa Group required extras for this particular Food City.

4. Mason Homes was to commence construction by April 1991, be substantially complete by November 1991, and permit Oshawa Group possession by February 1992, or Oshawa Group could elect within 30 days to terminate the Letter of Intent.

5. Finally, they agreed that they would conclude a construction agreement to be settled to the mutual satisfaction of both parties, failing which the Letter of Intent would "be null and void."

As you can likely now forecast, this last term became the focus of their $4 million dispute.

By December 1990, no written construction contract had been signed, though there had been substantial co-operations with the design consultants and their lawyers had negotiated and exchanged innumerable letters and faxes agreeing to all of the "material" terms. But, it was at this time that a problem arose: Oshawa Group had just learned that a competitor planned to build a big box food store nearby in a superior location. As a consequence, Oshawa Group no longer wanted to build a 36,000 ft^2 Food City. Thus, on January 22, 1991, it proposed to change the terms of the "proposed construction contract" to provide for a 20,000 ft^2 IGA food store. Mason Homes reviewed this proposal and quickly determined that this change would render the entire plaza project a money loser. It thus stopped the project, permitted the land to sit idle for 13 years, and sued Oshawa Group for breach of the Letter of Intent.

Oshawa Group raised many defences to the legal action, but for this review only two are substantial:

(i) The Letter of Intent wasn't sufficiently "certain" to be enforceable.

(ii) The Letter of Intent was null and void until they signed a written construction contract.

At the end of the case, the Ontario judge ruled that:

(iii) The Letter of Intent was sufficiently "certain";

(iv) A written signed construction contract was not necessary because the parties had mutually agreed to its "material" terms; and thus,

(v) Oshawa Group must pay Mason Homes damages of $4 million.

To come to these conclusions, the judge used three rules of interpretation for Letters of Intent:

1. Whether the parties in their minds thought the Letter of Intent was legally enforceable, or not, is not relevant. Rather, it is what can be discerned from what they wrote, what the circumstances were at the time the Letter was written, and what was then and later said and done which would clarify any ambiguities in the Letter without contradicting the clear words of the Letter.

2. The terms of the disputed Letter do not have to be "certain" in every detail. Rather, the "material" terms must be reasonably determinable, and a term is only "material" if it would be unfair to enforce the Letter by implying that the indefinite term is reasonableness in the circumstances.

3. Finally, it is a question of contractual interpretation whether a Letter of Intent is a mere expression of the desire of the parties to continue bargaining, or whether it is an enforceable contract to be later documented in a formal fashion. Where there is no express term in the Letter equivalent to the words, "subject to contract," as was the case here, it is Oshawa Group's onus of proof to show that clearly the words and circumstances of the Letter of Intent show that the parties clearly intended that it was not enforceable because it was subject to their signing a written formal construction contract.

With these three rules of interpretation, the judge concluded:

(i) The "material" terms of the construction contract (e.g. parties, price, and work – and in this case the construction schedule for the ancillary portion of the plaza) were clear from the letters and faxes exchanged between the parties and the lawyers during the 12 months of negotiations, while the 13-year-old faulty memories of the parties weren't a big deal.

(ii) Given term 4 used the words "30-day termination of Letter of Intent" and term 5 used the words "failing which … shall be null and void," which wouldn't be necessary if the Letter was simply an expression of a desire to continue to negotiate, it is clear that the parties intended the Letter of Intent to be legally enforceable.

(iii) While, the term 5 calling for negotiation of a construction contract did not use the words "subject to execution of a formal construction contract;" and thus the Court could search through the faxes and letters exchanged during negotiations to see whether there had been a "mutual satisfactory" agreement on the "material" terms.

Conclusion

So what should you do? My suggestions are:

1. If you intend the Letter of Intent to be simply a notice to get prepared for an award of a construction contract, say so by using words like, "subject to contract."

2. On the other hand, if you intend the Letter of Intent to announce the award of a contract, specify which contract form you intend because judges/arbiters will otherwise be searching your computers and documents for find clear evidence of the "material" terms, and this could include implying "*quantum meruit*" if no price is stated.

3. If as a builder you begin Work without first fixing the terms of your contract, it's very likely too late to avoid the terms of your last contract with the owner/general contractor.

4. And (this is an addition not found in the Ontario case), if as a builder you start Work when all you've got is a Letter of Intent "subject to contract," you will not be able to sue for *quantum meruit* and are thus left with a very expensive and risky action of "unjust enrichment" for realizing your costs for the Work done.

On the last point, Mason Homes did not sue for unjust enrichment, though it had incurred substantial consultant costs during the preparation of the drawings and specifications for the proposed Food City. I suspect that it did not do so because it had no evidence that Oshawa Group had received any lasting benefit because of the consultants' work and, thus, had not been "unjustly enriched." At the bottom line, for Mason Homes, it was $4 million or nothing!

NOTE: Soft costs were approximately $400,000, inclusive of consultant expenses.