

Which one prevails – a Letter of Intent or a Formal Contract? A Recent Case – Merit Process Engineering Ltd. v Balfour Beatty Engineering Services (HY), Ltd. [2012]



Hon Chi Yi, Ludwig
FHKIS

This case was named one of the **“Top 5 Construction Cases of 2012”** by Mr. Tom Heading, Associate, Norton Rose Group, Australia.

Fact

- 2.3.2004 – Balfour Beatty Engineering Ltd. (“BB”) (the sub-contractor) issued a Letter of Intent (“LI”) to Merit Process Engineering, Ltd. (the sub-sub-contractor) (“Merit”), inviting it to commence work under the terms of the LI, which stated that, “...subject to formal contract...”.
- BB wanted to confirm the sub-sub-contract with Merit after it confirmed the sub-contract with Costain, the Main Contractor.
- The limit of expenditure was originally £500,000, but increased to £1.6 million.
- The LI did not carry any arbitration agreement.
- 10.12.2004 – BB entered into a formal contract with Costain.
- 21.3.2005 – BB sent a proposed sub-sub-contract to Merit to sign.
- However, Merit did not sign the sub-sub-contract. It agreed to most of the issues. The difference in price was £37,550 and there was no formal agreement (contract) signed.
- Neither party proceeded on the formal sub-sub-contract, but Merit continued its work.
- In 2011, Merit issued court proceedings, claiming payment in respect of the works.
- However, BB applied for a stay of the court proceedings, relying on the arbitration agreement, as stipulated in the formal contract.

Held

- Justice Edwards-Stuart (“Edwards”) held that there was no agreement on the price of the works.
- Thus, there was no formal contract between the parties, as there was a dispute over the price.
- Edwards mentioned that although BB claimed that the difference in the amount (£37,550) seemed minimal, the profit margin in the construction industry was only around 2-3% of the value of the works. Hence, this amount was surely substantial.
- The works were carried out under the LI, which did not contain any arbitration agreement.
- As a result, the court dismissed BB’s application for such a stay.

Conclusion

1. This case was in direct contrast to the decision on the case, **Carrier Hong Kong, Ltd. v Dickson Construction Co., Ltd. [2005]**, in Hong Kong. In that case, the court upheld the ruling of the arbitrator, which stated that a contract existed despite not everything being agreed to by both parties.
2. To form a binding contract, concluded agreements between each party on **ALL the terms**, like prices, payment terms, scope of work, time scale, risk allocation, etc., is crucial in reference to this recent case.
3. This case also inserted a sunset date into the LI that will encourage both parties to resolve their negotiations before the works are complete, which is when most disputes start to appear. 🇺🇸