

## Letters of intent: the risks of contracting without a contract

**Letters of intent (LOIs) are commonly used to get construction projects underway while the formal contracts are being negotiated. However, starting works without an actual contract can lead to complications.**

### The perils of kicking the can down the road

LOIs let works get underway at an earlier stage, but they can provide a false sense of security that a project is ready to begin when the parties aren't actually aligned on fundamental points. This can result in confusion about pricing and who's doing what. This was well highlighted in *Electrix Limited v The Fletcher Construction Company Limited*.

Fletcher engaged Electrix as its subcontractor for electrical services on the Christchurch Justice and Emergency Services Precinct project. To keep things moving while the contract was negotiated, the parties agreed a series of nine LOIs. Ultimately, however, the parties failed to agree on a contract, leaving only those LOIs as the formal record of the relationship between them. By the time the project was finished, there were LOIs for \$14 million, Fletchers had paid \$21.6 million, and Electrix had issued payment claims for \$28 million.

Fletchers claimed the LOIs formed a contract that set the price at around \$14 million and sought a refund of the difference. Electrix argued that there was no contract so it was entitled to be paid a reasonable price for the services actually provided. The Court agreed with Electrix, and Fletchers was ordered to pay a further \$7.4 million plus interest at 5% p.a.

### Key takeaways

- LOIs are not a substitute for a contract. They

should be used with caution, and you should:

- check you are aligned with the other side on key terms (eg, due dates, liquidated damages, retentions and key responsibilities), and record those key terms in the LOI;
  - identify the terms that will govern your relationship if no contract is agreed; and
  - not allow the existence of an LOI to slow down your contract negotiations.
- Once works are underway:
    - competitive tension and commercial leverage may be lost; and
    - it can become harder to negotiate the contract if risks or problems have already arisen, as each side will attempt to contract its way out of the issues. So, you should lock-in as many key terms as possible before you commit to an LOI.
  - Where possible, you should complete the contract rather than enter into an LOI. This enables the contract to be finalised while there remains goodwill and commercial leverage, and enables a project to begin with clarity.

### Want to know more?

If you have any questions about starting a project in a way that reduces the risk of disputes, please contact [Anton Trixl](#) or [Steve O'Dea](#) from our specialist [Construction Team](#).

Other articles in the *construction essentials* series

- [The risks of attaching too many documents to a construction contract](#)

*Large construction contracts are a common source of complaint from principals and contractors alike,*

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**Letters of intent: the risks of contracting without a contract**  
(Continued)

*and with good reason: unintended risk allocations may lurk in that pile of paper.*

- [Payment schedules: why they need to be Spotless](#)

*Technical requirements for payment schedules can be a trap for the unwary, and errors by the paying party can cause it to have no choice but to pay even if it has a genuine reason to dispute the amount.*