

Airline Economics

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**Goshawk
swoops
on Sky**



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Letters of Intent: Are you (un)intentionally bound?

By Peter Morton, Sidanth Rajagopal and Hannah K. Davies, K&L Gates LLP



A party entering into a letter of intent (LOI) may consider it to be just that: merely an expression of intent which is not legally binding. However, from an English law perspective, the label that is given to a document is only one of a number of factors that would be considered as relevant in establishing whether the document creates legally binding obligations.

It is very important that careful consideration is given to whether there

is an intention to be bound and, if so, how to effectively record that in your LOI (or similar documents such as “Heads of Agreement”, “Heads of Terms” or “Term Sheets”). Just as importantly, if there is no wish to be bound, what can a party do to make that clear and avoid inadvertently concluding a legally binding contract?

It is perfectly possible for parties to enter into what is effectively an interim legally binding agreement, where the terms are agreed in outline only, with the full terms to be embodied in a

subsequent more detailed agreement to be executed subsequently.

By way of a recent example of how these issues can arise in the aviation sector, in the case of *Novus Aviation Limited v Alubaf Arab International Bank BSC(c)* [2016], the parties entered into a “Commitment Letter” under which the bank agreed to provide equity to Novus Aviation for an aircraft purchase. The bank did not consider the letter to be binding, whereas Novus Aviation understood the letter to be binding. The bank then decided



it no longer wanted to enter into the transaction, and Novus Aviation sued the bank for damages for breach of the Commitment Letter. Although Novus Aviation had not countersigned the Commitment Letter and it stated that the lender's commitment to the transaction "shall be conditional upon satisfactory review and completion of documentation", the court held that due to the language of the letter and the provisions contained therein, the Commitment Letter was binding on the parties.

It is clear that, under English law, an assessment of whether or not an LOI is legally binding will require consideration of the document as a whole, as well as the language used in the LOI/ its features. In this article, we consider the relevant considerations from the English law perspective.

WHEN IS AN LOI BINDING IN THE EYES OF THE LAW?

It is very important to consider the relevant issues that a court (or arbitrator) would consider in deciding whether an LOI (or similar such document) represents a legally binding contract, namely the following components which must be present for a binding contract to exist:

- a. Offer;
- b. Acceptance;
- c. Consideration;
- d. Intention to create legal relations; and
- e. Certainty of terms.

The first three components will normally exist purely from the parties drafting and signing an LOI, which sets out the key terms of the transaction between the parties, including the payment of any deposit and any agreed price.

The issue of whether there is an intention to create legal relations requires further analysis which is set out in the paragraphs below.

With regards to the final requirement (certainty of terms), the finding of a document being too uncertain as to be unenforceable, is a last resort for the court. If the court has concluded that the parties intended to create legal relations, the court will make every effort to give effect to the parties' intention by construing the words used in a way which gives them practical meaning such that the document does not fail for uncertainty.

HOW DO YOU ENSURE THE LOI MAKES IT CLEAR WHETHER THERE IS AN INTENTION TO CREATE LEGAL RELATIONS?

In determining whether the parties intended to create legal relations, the court will consider the language of the LOI and surrounding circumstances

and whether that leads objectively to a conclusion that legal relations were intended by the parties. The court is not generally concerned with the subjective states of mind of the parties when making this decision.

The starting point for the court in a commercial context is normally that the parties intended the letter to be legally binding. Where there is an agreement and the subject of that agreement relates to business affairs, the onus of demonstrating any lack of intention to be bound will be on the party asserting it.

To argue/defend a claim that an LOI is/is not binding, all aspects of the LOI should be considered. In this regard, it is worth noting that a "subject to contract" label - whilst indicative that a document is non-binding - may not be conclusive that there is no intent to create a legally binding contract: the language of the LOI can waive/ 'trump' a "subject to contract" stipulation on the face of the LOI.

The inclusion of certain provisions will indicate that the parties have intention to create legal relations. For example, in the Commitment Letter between Novus Aviation and Alubaf Arab International Bank BSC(c), the use of both the word "covenants" and the mandatory word "shall" with respect to obligations within the Commitment Letter, (and somewhat unsatisfactorily, the inclusion of a governing law provision) led to the finding that the parties intended to create legally binding relations.

CONCLUSION

Disputes frequently arise as to whether an LOI (or similar such document) is legally binding or not. To limit the risk of such disputes arising, it is vitally important that parties consider all aspects of any proposed LOI, and take legal advice as necessary, to ensure that the signed document has the intended effect. By taking these steps, parties ought to avoid ending up in a situation of being un-intentionally bound by an LOI, and similarly should avoid concluding an LOI in the belief that it is legally binding when, on analysis, the language and features of the LOI leave the counterparty free to walk away.

DO YOU INTEND THE LOI TO BE LEGALLY BINDING?

YES

- Establish with the other party the objectives of the negotiations and record them clearly and concisely in the LOI. Ensure the LOI is complete and is not lacking any essential terms of the transaction.
- Label the LOI “Binding letter of intent”.
- Agree upon the following terms and include these within the letter:
 - a. Intention of the parties for the terms of the LOI to be legally binding and effective upon signature;
 - b. Payment mechanics, for example, payment clause setting out the amount, payment mechanism and timeline for payment including reference to any deposit agreed;
 - c. Termination clause setting out the grounds upon which the parties may validly terminate the LOI; and
 - d. Boilerplate clauses including confidentiality, exclusivity, governing law and jurisdiction.
- Use clear and unambiguous language which undoubtedly shows intention to impose actual obligations on the parties, e.g. Party X “shall...”; Party Y “covenants...”.
- Act in a way which evidences the legally binding nature of the terms contained in the letter and comply with the terms and obligations contained therein.

NO

- Name the document “Non-binding letter of intent, subject to contract”.
- Agree upon the following terms and include these within the LOI:
 - a. The intention of the parties is not to be contractually bound by the LOI; and
 - b. Negotiations may be terminated without liability at any time until a definitive agreement has been executed.
- Consider and agree upon those terms which should be legally binding, for example those provisions relating to confidentiality and costs of the negotiation, and clearly divide these parts of the LOI from the rest of the document by stating that the LOI is not intended to be a legally binding contract, except for the following clauses [list the applicable clause numbers] which the parties have agreed are binding.
- Act in a way that is consistent with the non-binding nature of the LOI, including ensuring that any statements or actions that may indicate that the LOI is understood by the parties to be binding are avoided.
- Mark all correspondence before and after entering into the LOI as “subject to contract”.



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