

## The Ties that Bind: Commitment Letters under English Law

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*A recent decision of the UK Commercial Court sounds a cautionary note to parties entering into pre-contractual deal documents on the assumption that they do not constitute legally binding obligations. In Novus Aviation Limited v. Alubaf Arab International Bank BSC (c) [2016] EWHC 1575 (Comm), a commitment letter signed by one party only was held to constitute a binding contract and funding obligations that were conditional upon a further review of full transaction documents were enforceable against a bank. Financial institutions and lessors should take note and ensure that preliminary documentation is expressly caveated to avoid being held to the terms of a letter of intent or term sheet.*

### Managing the Fall-Out: Suggested Steps

The decision points to the English courts' long-standing preference to uphold rather than strike down bargains. There is a real risk that pre-contract documents – which are often viewed by parties as statements of intent or “agreements to agree” – can be construed as legally binding agreements. Commitment letters are frequently issued by financial institutions prior to full contracts, and qualifying a bank's commitment by reference to its satisfactory review of deal documentation does not provide an unrestricted walkaway option. Parties should remember that:

- if a document is intended to be an indicative statement of intent, it should expressly state that it is not legally binding;
- if a party wishes to retain a general walkway right (on the basis of commercial or other interests), it is advisable to include an express option to do so;

- a document should require acceptance of its terms to be indicated only through countersignature (and for any waiver of this requirement to be issued in writing). Absent such stipulation, acceptance can be construed through the conduct of the parties in, for example, progressing the transaction;
- a party's signatory may be presumed to have all requisite authority to bind that party to the terms of a document, unless the contrary is expressly stated; and
- finally, conduct is key: courts may look outside the four corners of a document to infer the existence of a contract through conduct of the parties. Emails and internal records of telephone calls may also be referred to ascertain an intention to create a contract.

### The Facts

The claimant, Novus Aviation Limited, an international aircraft leasing and financing company sued the defendant, Alubaf Arab International Bank BSC(c), a Bahraini bank, for repudiatory breach of contractual obligations contained in a commitment letter.

The letter required Alubaf to fund 99% of the equity investment (worth roughly US \$40 million) required for the purchase of an Airbus A330-300 aircraft for lease to Malaysia Airlines. Novus was to arrange the remaining US \$70 million debt funding. Alubaf's commitment was stated to be "conditional upon satisfactory review and completion of documentation for the purchase, lease and financing" of the aircraft and subject to the transaction realizing a certain minimum net cash return. The letter also included a "time of the essence" clause (providing that all transaction documentation was to be completed at least four weeks prior to expected delivery of the aircraft) and a covenant by Alubaf to pay all transaction costs and expenses.

After Alubaf's investment committee approved the deal in early May 2013, a scanned copy of the commitment letter printed on Alubaf letterhead and signed by Alubaf's Head of Treasury and Investments was sent by email to Novus. Countersignatures from Novus were never returned to Alubaf. Throughout May 2013, several steps were taken to progress the deal (including incorporation of transaction SPVs, circulation of KYC information, and preparation of draft transaction documents). However, early in June 2013, Alubaf's board of directors declined to approve the transaction due to accounting concerns which were based on including the aircraft as an asset (and the US \$70 million loan as a liability) of the bank.

Novus claimed that the commitment letter constituted a binding contract which was repudiated by Alubaf, and sought damages in excess of US \$8 million for the lost opportunity to earn fees it would otherwise have earned.

### The Decision

Alubaf's liability turned on whether its obligations under the commitment letter were legally binding. Alubaf argued that the commitment letter was not intended to constitute a binding contract; the conditionality of its funding obligations rendered them uncertain; its signatory to the letter had no authority to bind Alubaf; and the letter had not been countersigned by Novus. Each of these arguments was rejected.

- *An intention to bind?* An intention to enter into legal relations is established not by the parties' "subjective state of mind" but by whether their communications (through words or conduct) evidence an objective intention to do so. The commitment letter was drafted in "the language of legal obligation" (including mandatory words like "shall" and "covenant") and incorporated a governing law clause to regulate legal relations. While possible for a document to be partially binding, a strong distinction

(absent in this case) would need to be drawn between those terms intended to be legally binding and those terms which were a statement of intention only. The drafting of the letter therefore indicated an intention to enter into legal relations.

- *Conditionality*: while Alubaf's funding obligations were, under the terms of the commitment letter, conditional upon its "satisfactory review and completion of [transaction] documentation", the court considered this leeway to be limited. Alubaf could not claim an unqualified right to reject documentation as unsatisfactory, and its discretion to do so must (absent clear language to the contrary) be exercised in good faith and not in an arbitrary or capricious manner.
- *Signatory authority*: while the court was satisfied that Alubaf's signatory had, in fact, actual authority to bind the bank, it relied primarily on his "apparent authority" to do so which was sufficient in law. Given the designation and role of the signatory and his conduct in acting as Alubaf's representative, it was reasonable for Novus to assume that the commitment letter had been duly executed by the bank.
- *Countersignature*: the terms of the commitment letter provided for Novus to indicate its acceptance through countersignature. The court agreed that while Novus' acceptance was required in order for a contract to come into effect, countersignature was not (absent a specific stipulation) the only way of establishing acceptance. Novus' conduct following receipt of Alubaf's signature (including email correspondence and steps taken to progress the transaction) was sufficient to communicate its acceptance, and nothing in Alubaf's conduct raised any doubt as to whether the commitment letter was in place.

As the commitment letter was an enforceable contract, Alubaf's withdrawal (which was based on a general assessment of its commercial interests) was held to constitute an anticipatory repudiatory breach of its obligations thereunder.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the attorneys below.

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