

Commitment letters: some hard lessons

Every so often a judicial decision crops up saying nothing new about the law but with facts so close to home that it creates jitters. *Novus Aviation v Alubaf Arab International Bank*¹ is one such example. The bare facts may seem disturbing: how can a court find that a financial institution is obliged to invest under a commitment letter that was expressly conditional upon its "satisfactory review and completion of documentation" and that had not been signed by its counterparty? However, a closer look shows that this outcome was unsurprising in the circumstances and that it contains valuable lessons for those involved in preparing, or entering into, commitment documentation.

The facts

Alubaf signed a commitment letter addressed to Novus in which it agreed to provide the equity portion in an aircraft acquisition and leasing deal which Novus was arranging. The letter said that Alubaf's commitment "shall be conditional upon satisfactory review and completion of documentation for the purchase, lease and financing...". Despite the letter anticipating signature by both parties Novus did not countersign the letter and the parties proceeded with the transaction. Alubaf later withdrew from the transaction. Not because it was dissatisfied with the documentation but because it became concerned about the accounting implications of the deal (it was advised that it would have to consolidate the SPV that was to acquire the aircraft, including the SPV's bank debt). Novus sued for breach of contract. Alubaf argued that:

- the commitment letter was not intended to create legal relations;
- the condition to Alubaf's commitment meant that Alubaf was entitled to withdraw; and

- in any event the commitment letter was not binding on either party because Novus had not signed it.

The decision

Whether a document is intended to create legal relations is assessed objectively by reference to what was agreed by the parties and communicated between them. On the facts the court decided that Alubaf and Novus had intended the commitment letter to be legally binding as it included a governing law and jurisdiction clause, used language indicative of obligations such as "shall" and "covenants" and did not say that it was not binding.

The court decided that, as a matter of construction, the condition to Alubaf's commitment was a single condition, not separate requirements of satisfactory review and of completion of the documentation. The condition was sufficiently certain, and it was a matter of fact as to whether Alubaf had withdrawn for the specified reason. Crucially Alubaf did not have free rein to withdraw. This was

Key issues

- If a commitment letter is not intended to be legally binding it needs to say so.
- A documentation "out" does not give an unfettered right to walk away.
- Absence of a party's signature does not necessarily mean there is no binding agreement.

because the condition gave Alubaf a contractual discretion rather than an absolute right. Accordingly, absent very clear language to the contrary, the discretion had to be exercised in good faith for the purpose for which it was conferred and not in a manner that was arbitrary, capricious or irrational – in essence Alubaf only had a right to withdraw if it genuinely considered the documentation unsatisfactory. Alubaf's withdrawal was not based on any dissatisfaction with the documentation but solely because of the accounting

¹ *Novus Aviation Limited v Alubaf Arab International Bank BSC (c)* [2016] EWHC 1575 (Comm)

implications – accordingly the condition did not entitle it to withdraw.

Finally the court decided that although the commitment letter required Novus to accept the terms before an agreement was concluded and the letter became binding, it did not say that it would become binding only on signature by both parties. Accordingly Novus could signal its acceptance by conduct which, on an objective basis, showed an intention to accept the terms. On the facts Novus had done this by proceeding with the transaction.

The lessons

Whilst the decision is merely an illustration of the application of existing law and says nothing new, it highlights a number of potential traps for the unwary. The key lessons are set out below.

- If a party does not intend a commitment letter or similar document to be legally binding, it is crucial to make this clear on the face of the document itself. In the absence of doing so it is likely that if a document looks as if it is intended to be a binding contract the courts will endeavour to find a way to make it so, particularly in a commercial context.
 - Conditionality based upon a party's satisfaction with final documentation is not a panacea and does not give that party an unfettered right to walk away, particularly if the final documentation is not actually the problem. Absent very clear language to the contrary, this type of discretion is, in lawyers' jargon, required to be exercised in good faith for the purpose for which it is conferred and not in a manner that is arbitrary, capricious or irrational.
- This is a fairly low bar and does not mean that the exercise of discretion is subject to the court's review of what may or may not be reasonable on an objective basis. However it does require that the decision maker takes the right matters into account. This was the crucial factor in this case: Alubaf were not entitled to rely on a documentation "out" when their decision to withdraw had nothing to do with the documentation. Had their commitment been expressed to be subject to "*satisfactory review of accounting treatment*" it is likely that the court's decision would have been quite different.
- If it is important that a commitment be conditional upon something, be that satisfactory documentation, credit approval, due diligence, AML procedures or accounting implications, the commitment letter should say so – it will not be possible to rely on a condition that deals with something else.
 - Whilst it is clearly better for a commitment letter to be signed by all parties to put the question of agreement beyond doubt, a commitment letter will not necessarily be ineffective simply because it has not been signed by one of the parties. The crucial issue is whether there is sufficient evidence which, as a matter of objective analysis, shows agreement and intention to be bound: that evidence can take other forms, such as, in this case, the parties' conduct.

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