



## LETTER OF OFFER: CAN IT STAND ALONE?

While looking for a suitable bank to finance your housing loan or corporate loan, you may stumble upon a preliminary document called a letter of offer. A letter of offer is an excellent first step which allows the parties to agree on the key commercial terms, which may be non-negotiable, before executing formal documents. In Malaysia, most of the banks treat letter of offer as an integral part of the facility agreement due the weight carried by the letter of offer itself. Not only that it gives an overview of the financing structure, but it also records the commercial terms initially agreed between the parties during the negotiation stages. Even though letter of offer is non-binding, it is a good approach for Banks to treat letter of offer as an integral part of the facility agreement. This is to avoid any confusion as to which document is enforceable in the court of law, especially when the issue surrounding 'subject to contract agreement' are involved. It is not simple to have a legally binding contract. The journey starts with an offer and acceptance, consideration, intention to create a legal relation and the capacity to enter into a valid and binding contract. Yet, the point at which a binding agreement is finally reached between the contracting parties is still unclear and debatable. In some cases, even though all contractual elements are present, the inclusion of "subject to contract" provision could have reversed the outcome of the case.

In the law of banking, a letter of offer is broadly used in most of the facilities offered by banks to its customer. The question is does a letter of offer is more than merely pre-contractual negotiation and of material importance such that it has a bearing on the facility agreement? Can the letter of offer stand alone as a contract in the absence of the facility agreement? Theoretically speaking, letter of offer and its acceptance may constitute a valid contract in the conventional banking system which binds the contracting parties. The bank may disburse the loan amount to the customer after getting a confirmation that the customer has accepted the terms and conditions of the letter of offer. Nevertheless, this may not be the case in Islamic financing. Letter of offer in Islamic financing is a good example of 'subject to contract' agreement. 'Subject to contract' agreement may not always be expressly phrased in an agreement. There are numerous ways to express terms to the same effect. In Islamic financing, acceptance of the letter of offer is just an acceptance to the terms and conditions contained therein and not an acceptance to the sale transaction. The letter of offer can be considered merely as memorandum of understanding between the bank and the customer which consist of the agreed terms between the parties while the negotiations are still ongoing. The actual contract of sale and purchase will only be concluded after the bank and customer execute the Property Purchase Agreement or the Facility Agreement.<sup>1</sup>

The Supreme Court in a landmark case of ***Ayer Itam Tin Dredging Malaysia Berhad vs YC Chin Enterprise Sdn Bhd***<sup>2</sup> held that arrangement made 'subject to contract'

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<sup>1</sup> Zulkifli Hassan, A Shari'Ah Perspective On The "Letter Of Offer" As Practised by the Islamic Financial Institutions: A Comparative Study with the Malaysian Law of Contract.

<sup>2</sup> [1994] 2 MLJ 754.

or 'subject to the preparation and approval of a formal contract' and similar terms would mean that the parties were still in negotiations and did not intend to be bound until a formal contract was agreed.

In the case of **Turriff Construction Ltd. vs Regalia Knitting Mills Ltd**<sup>3</sup>, a Letter of Intent was issued by Regalia Knitting to Turriff Construction to urgently commence construction of a factory with the intention that Regalia award a contract to Turriff subject to an agreement and acceptable contract. Turriff agreed to commence work provided that Regalia undertake liability for its work done. The Court held that Regalia was still liable to Turriff because a subsequent contract was made in that Regalia had agreed to undertake liability for Turriff's work done and it could not be construed as part of the subject to an agreement of an acceptable contract as stated in the Letter of Intent pending the acceptable contract. The Letter of Intent was merely an expression of an intention to enter into an acceptable contract and therefore, not a binding contract but the subsequent contract which Regalia agreed to undertake was a binding one.

Based on the above analysis, it can be observed that when the element of 'subject to contract' is present, the contracting parties are not bound by any contractual obligations. In this context, in the case of a letter of offer, if it has been expressly spelled that the letter of offer is subjected to the execution of a facility agreement, the bank and the customer are bound only to the extent of the facility i:e the bank is obliged to grant the financing facility and the customer has to meet the conditions precedent contained in the Letter of Offer. There is no obligation to the bank to disburse the financing amount to the customer until the execution of a facility agreement between the parties which stipulates the terms and conditions of the financing.

As a result, the insertion of a 'subject to contract' clause does not always guarantee that binding contract has not been concluded. The decision depends on the facts of the situation as well as the language used in each case. In the case of **Abdul Rahim Bin Abdul Hamid v Perdana Merchant Bankers Bhd**<sup>4</sup>, a variation was made in the facility agreement which contradicts the term sheet agreed between the parties during the negotiation. The Borrower had executed the facility agreement believing that it must have reflected all the terms and conditions agreed in the term sheet. It was later found out that there was a variation made in the facility agreement which was not in accordance with the term sheet. It was decided that the term sheet constituted an important document, given the evidence that the facility agreement was merely meant to formalize what was agreed upon by the parties in the term sheet. The conduct of the bank in relation to the amendment of the facility agreement was in breach of a bank's duties as bankers to their customers.<sup>5</sup>

In the case of **Khaw Kim Chua & Anor v Dayani Sdn Bhd**<sup>6</sup>, it was decided that the Memorandum of Understanding ("MOU") was a binding contract although no sales and purchase agreement was entered between the parties because the Defendant had benefited from the MOU when the Plaintiff acted in accordance with the MOU. This case has demonstrated that the acts of the parties subsequent to the contract also give credit in

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<sup>3</sup> [1971] 9 BLR 20.

<sup>4</sup> [2006] 3 CLJ 1.

<sup>5</sup> Ibid at 4.

<sup>6</sup> [2005] 6 CLJ 260.

deciding whether the parties intend to be bound by contractual obligations at the point of entering into the contract.

Based on the cases above, there is no definite answer as to whether there is a valid and binding contract or not during the pre-negotiation stages. It is very much depending on the facts of each and every case. It goes back to the intention of the contracting parties whether they intend to be bound by the contractual obligations or not. As there is no hard and fast rule in drafting a letter of offer, financial institutions must have a clear intention whether to have a letter of offer which bind the parties or subject to formalization of a contract. If possible, the letter of offer should be structured in such a way that it forms the basis of a formal contract that would be concluded between parties while maintaining an appropriate balance of risk for both parties.

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WRITTEN BY:



Nur Farhana binti Abdul Karim  
Associate, EzriLaw Firm  
[farhana@ezri.my](mailto:farhana@ezri.my)