

Has a contract been formed?

Work is all too often carried out in the construction industry without the terms of a contract having been first agreed. The perils of this situation are well illustrated by **RTS Flexible Systems Ltd v Molkerei Alois Muller & Co KG**, a case which reached the Supreme Court, where judgment was given on 10 March 2010.

The case involved the supply, installation and commissioning of an automated system of packaging yoghurt pots. The work was commenced pursuant to a letter of intent. Following the expiry of the period covered by the letter of intent, the work continued, while the parties negotiated over the detailed terms of the contract. It was envisaged that the contract would be on the MF/1 conditions, clause 48 of which provides that a contract will only come into effect on the contract being executed. No contract was ever executed, although most of the terms were agreed in correspondence.

The judge at first instance held that a contract had been reached between the parties on limited terms, which did not include the MF/1 conditions. He ruled that, in circumstances where the work had been completed, it was unrealistic not to conclude that a contract had been formed. The Court of Appeal concluded that no contract had been formed. The Supreme Court decided that a contract was formed on the MF/1 conditions (as amended by agreement).

The Supreme Court set out the well-established principles that govern the question of contract formation, including the principle that contracts may come into existence, not as a result of offer and acceptance, but during and as a result of performance. The intentions of the parties are assessed objectively. Like the judge at first instance, the Supreme Court concluded that it was unrealistic to suppose that the parties in this case did not intend to create legal relations, which is the basic test for determining whether or not there is a contract. However, the Supreme Court departed from the decisions of both courts below, by ruling that the parties must be held to have waived the stipulation in clause 48 of the MF/1 conditions concerning the necessity for formal execution of the contract.

So, three different courts, three different decisions, and, one suspects, horrendous costs. As was said in the Supreme Court:

'The different decisions in the courts below and the arguments in this court demonstrate the perils of beginning work without agreeing the precise basis upon which it is to be done. The moral of the story is to agree first and to start work later.'

The judge at first instance commented that the case was another example of the perils of proceeding with work under a letter of intent. It might sometimes be thought that to start work with a letter of intent is better than having nothing at all. The object of a letter of intent is indeed to enable work to start without the parties being committed (beyond a certain point) unless and until the terms of a full contract are agreed. In practice, however, once work is started, it may be difficult to stop.

The problem of whether there is a contract, and if so on what terms, in circumstances where the work has been carried out, will be more likely to arise as an issue in adjudications if/when the amendments to the Construction Act come into force. The Construction Act stipulated that, for a contract to be subject to the Act, it had to be in writing or evidenced in writing. The purpose was to limit difficult issues over contract formation. The amendments to the Act remove this requirement, and will thus make it possible for all the issues debated in this case to be referred to an adjudicator for a decision.

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Beale and Company Solicitors LLP

London: Garrick House · 27-32 King Street · Covent Garden · London · WC2E 8JB · T: +44 (0)20 7240 3474

Bristol: Venturers House · King Street · Bristol · BS1 4PB · T: 0117 915 4021

Dublin: Hamilton House · 28 Fitzwilliam Place · Dublin 2 · T: +353 (0) 1 775 9505