

Contract Formation
Rachel Barnes, June 2010

As things stand, a dispute under a construction contract can only be referred to adjudication if the contract is in writing or evidenced in writing. This requirement has been removed by recent legislation, which is waiting to be brought into force. However, for an adjudicator to have jurisdiction it will still be necessary for there to have been a contract between the parties.

The requirement that the contract be in writing was presumably intended to avoid adjudicators having to deal with difficult issues over whether there was a contract and, if so, what the terms were. But when the new law comes into effect, that's what they'll have to do.

All too often, work on a project starts without a contract having been concluded. Contract negotiations take place while work is proceeding, but whether they reach a conclusion, and if so what sort of conclusion, may be unclear. Tim Elliott wrote about one such case – RTS Flexible Systems v Molkerei Alois Müller GmbH - in these pages a few weeks ago. The view of the Supreme Court there was that it was unrealistic to suppose that there had been no contract between the parties on the MF/1 terms, despite the stipulation in those terms that they would not become effective until the contract had been executed by the parties. This never happened.

Contract formation is sometimes thought to be a question of offer and acceptance; has an unconditional offer been unconditionally accepted? However, in a situation of any complexity, where the existence or terms of a contract are being disputed, this approach is unlikely to be helpful. It is more likely that a contract will have come into existence, if at all, as a result of work being carried out.

The basic test for determining whether there is a contract is whether the parties intended to create legal relations. This has to be judged objectively. What the parties say they intended is usually inadmissible. The parties must be assumed to have acted as reasonable business people and what they said and did is to be assessed in this light and in the light of what, as reasonable business people, they would be assumed to have thought and known. As a result, inferences as to what they intended may have to be drawn from their behaviour. In RTS Flexible Systems, the court inferred that the parties had waived the requirement in the MF/1 terms that the contract had to be executed before it came into effect, although there was no evidence before the court that the parties had in fact considered the point.

A potentially misleading approach to contract formation is to consider whether the parties have agreed on all essential terms. It would be wrong to conclude that a contract was formed once the parties had agreed all the terms that a judge (or arbitrator or adjudicator) considered essential. What is relevant is what terms the parties intended to agree before considering themselves contractually bound. There may, of course, be terms that seem so important that one would not expect the parties to intend to be contractually bound without their being agreed, but everything must be judged in the light of the admissible evidence. There may also be situations where, if an obviously crucial term has not been agreed, the contract would be void for uncertainty.

The objective approach permits a robust approach to the evidence. The old-fashioned literalist approach of dictionaries and grammars and syntactical analysis is out of favour. What someone actually wrote may be considered less important than what they, as the hypothetical reasonable business people, must be assumed to have meant. The Supreme Court was clearly indicating, in RTS Flexible Systems, that, where work has been carried out, the likelihood is that a contract was formed somewhere along the way. A fair amount of confidence on the part of adjudicators or anyone else may be needed when called upon to decide how and when this may have occurred. They will often need to move beyond a literal analysis of the correspondence and other relevant documents, but must not get carried away: their conclusions should still be based upon, and not inconsistent with, the admissible evidence.

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Unfortunately, even sound adjudicators' conclusions are likely to be challenged. Contract formation is a jurisdictional issue as far as adjudication is concerned. Adjudicators' rulings on jurisdiction are not binding on the parties, unless they have agreed to be so bound. Adjudicators should still rule on jurisdictional issues, and do so at an early stage. If, however, the issue is difficult, it is usually best to refer it to the court for decision before more costs are incurred in the adjudication. In such cases, the best course for adjudicators may be to encourage the parties to do just that.

Published in Building on 4 June 2010.

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