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## SUBJECTED TO A CONTRACT

By James Fielden and Tom Duncan

As readers will know, it is far from unusual for parties on a construction project to start significant works before they have agreed and executed a formal contract – often relying upon a letter of intent. The idea is to get on with the job and worry about the detailed paperwork later. However, often that paperwork never gets sorted out and, when disputes arise, arguments about the formation and terms of the parties' agreement inevitably follow. Lawyers and claims consultants make hay over the confusion which results. A recent example of this is the case of *RTS v Molkerei*, which went all the way to the Supreme Court (previously the House of Lords). The Supreme Court's decision is notable both because it provides a useful summary of the legal principles on contract formation and because it considers the position when the negotiations between the parties are "subject to contract".

The general principle was summarised as follows: whether there is a binding contract and upon what terms depends on what was communicated between the parties – either by words or conduct – and whether that leads objectively to a conclusion that they intended to create legal relations and had agreed all the legally essential terms. It is the *objectivity* that is important: the Supreme Court made clear that English law generally ignores the subjective intentions or reservations of the parties and instead uses the expectation of the "reasonable honest businessman" to decide whether a contract has been formed.

With this in mind, the Supreme Court considered whether or not a contract existed in circumstances where the draft, unsigned contract expressly stated that it "would not become effective until each party has executed a contract and exchanged it with the other". The court noted that, despite the fact that the agreement had not been executed, the parties had agreed all the essential terms and substantial works had been undertaken. It was not until the parties were in dispute that arguments were raised as to whether there was actually a binding contract. As a result, the Supreme Court held that the parties had agreed to waive the "subject to contract" clause – i.e. a contract between the parties *did* exist – and that any other conclusion made no commercial sense and could not be reached by any reasonable honest businessman.

The decision is a warning to parties who seek to use technical arguments after the event that the Courts will not shy from looking beyond expressions such as "subject to contract" in order to ascertain the objective intention of the parties. It is also another example of the importance of executing a contract at an early stage. Failure to do so in this case led to three trials in three courts, each of which reached a slightly different conclusion. It might not seem like a priority at the beginning of the works when the pressure is on, but if the contract had only been signed up, all of that uncertainty and cost would have been avoided.



**James Fielden**

Partner,  
Construction & Engineering  
[jfielden@mayerbrown.com](mailto:jfielden@mayerbrown.com)



**Tom Duncan**

Associate,  
Construction & Engineering  
[tduncan@mayerbrown.com](mailto:tduncan@mayerbrown.com)