

Review

Commercial & Dispute Resolution



When actions speak louder than words: the dangers of commencing works under a letter of intent

On 10 March 2010 the Supreme Court delivered judgment in *RTS Flexible Systems Ltd v Molkerei Alois Muller GmbH & Company*, finding that the parties were bound by the terms of a draft contract which had not been signed and despite an express subject to contract provision, where they had commenced performance of the contract under a letter of intent.

Background

In this case RTS had contracted with Muller to supply an automated system for packing yoghurts. It was agreed that the parties would begin work on the basis of a letter of intent while they negotiated the terms of the final contract. The letter of intent expired after 4 weeks but, despite that no final contract had been signed, RTS continued work on the project. A dispute arose between the parties regarding whether the works fulfilled Muller's performance requirements.

It is notable that during the course of negotiations a draft contract had been circulated between the parties and almost all of the terms had been agreed. This draft contract contained a subject to contract clause which stated that *"the Contract shall not become effective until each party has executed a counterpart and exchanged it with the other"*.

The Supreme Court was asked to consider the following two issues:

- (1) is there a binding agreement between the parties and, if so, what are the terms of that agreement?
- (2) what is the effect of the "subject to contract" provision?

Judgment

Previously, the High Court had held that there was a binding agreement between the parties on some but not all of the terms of the draft contract. Critically, the terms limiting RTS' liability to Muller were not included. This decision was overturned on appeal, the

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Court of Appeal holding that the subject to contract clause operated to prevent an agreement being made.

The Supreme Court held that there was a binding agreement between RTS and Muller on all of the terms of the draft contract. An “honest, sensible businessman” when objectively assessing the parties’ words and conduct would reasonably conclude that the parties intended to be legally bound. By performing their ‘contractual’ obligations the parties had waived the subject to contract clause which rendered it ineffective.

Comment

This case highlights the danger of beginning work on a project before a final contract is signed. A lack of a contract is not a problem whilst the commercial relationship is working well but if the relationship breaks down considerable cost could be involved in establishing what the contractual position is and what the parties’ obligations, rights and remedies are. In this case, the parties had to litigate through the entire English court system to establish this, which will have involved significant cost. To avoid this situation arising, parties are advised to seek legal advice at the outset of a project and throughout the contractual negotiations.

The final words are those of Lord Clarke in the Supreme Court who said *“the different decisions in the courts below and the arguments in this court demonstrate the perils of beginning work without first agreeing the precise basis upon which it will be done. The moral of the story is to agree first and to start work later.”*

FURTHER INFORMATION

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