



## Commercial Briefing

### RTS Flexible Systems Limited: more practice points on contract negotiations and drafting

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Our last Commercial Briefing examined lessons from the recent *BSkyB v EDS* decision. These included the need to exercise caution when making statements during pre-contract negotiations and how carefully drafted documentation can offer a safety net when things do not go to plan.

Although the circumstances were different, the Supreme Court's recent decision on preliminary issues in *RTS Flexible Systems Limited v Molkerei Alois Müller GmbH & Co KG* is a further reminder of the need to exercise caution during contractual negotiations.

#### What are the facts?

At the beginning of 2005, Müller (a supplier of dairy products) and RTS (who manufacture and supply packaging machinery) began negotiations for the supply and installation of machinery at one of Müller's factories. Following receipt of a letter of intent, RTS started work on the project while the formal terms of the contract were being negotiated. The letter of intent expired in May 2005 without a contract having been signed. Despite this, RTS carried on with the work whilst the parties continued negotiations.

By 5 July 2005, a draft final contract was produced. Among its terms was Clause 48, which provided that the contract would "not become effective until each party has executed a counterpart and exchanged it with the other". This never happened. Subsequent problems led the parties to renegotiate the project delivery plan in August 2005.

A dispute later arose between the parties, necessitating a trial of preliminary issues regarding the existence of a contract between the parties and its terms.

In the High Court, the judge held that there was a contract between the parties which incorporated some, but not all, of the terms in the draft final contract. The Court of Appeal subsequently overturned this judgment, finding that there was no contract at all after the expiry of the letter of intent because Clause 48 operated as a "subject to contract" provision, preventing any contract coming into effect until each party had signed.

The Supreme Court was left to decide whether, following the expiry of the letter of intent, a contract had been entered into, and, if so, on what terms.

#### What did the judgment say?

The Supreme Court identified two heads under which the issues in this case fell: firstly, whether the parties had agreed all the terms essential for the formation of a legally binding agreement; and secondly, the effect of the "subject to contract" provision in Clause 48.

The Supreme Court held that the evidence clearly pointed to there being a contract between the parties. It was a striking feature that essentially all of the terms were agreed by 5 July 2005, that substantial works were carried out by RTS and that payments were made by Müller for those works. In addition, important variations were agreed in August 2005, with no suggestion at the time that there was no contract to vary.

As to the terms of the contract, the Supreme Court disagreed with the decision at first instance that only some of the provisions of the draft contract were incorporated into the final agreement between the parties. It made no commercial sense to hold that the work was carried out on some, but not all, of the terms agreed by 5 July 2005.

The Supreme Court accepted that, as found in the Court of Appeal, the "subject to contract" condition in Clause 48 meant that the draft contract could not become binding without compliance with its terms. However, the Court of Appeal had not gone on to consider the possibility that this provision had been waived. Any such waiver would have to be unequivocal, but need not be an express statement. In this case, it could be inferred from communications between the parties and their conduct that they had waived the "subject to contract" condition in Clause 48 and, accordingly, that a contract had arisen between the parties.

## Practice points

The Supreme Court highlights at the outset that "the moral of the story is to agree first and start work later". Clearly, this isn't always possible in practice. What the case does demonstrate is that this situation should be avoided if at all possible, because parties may find themselves without the benefit of important contractual protections. If it is unavoidable, parties should ensure they properly document their rights and obligations during this interim period.

A related lesson is not to let contractual negotiations drift, without reaching a clear conclusion. In this case, failure to follow matters up left the question of whether there was a contract at all, and its precise terms, open to debate. The perils are illustrated by the fact that different interpretations were given at first instance, in the Court of Appeal and by the Supreme Court.

Take care with what are often considered to be "boilerplate" clauses. Clause 48 was headed "Counterparts", but on its wording it was also interpreted as a "subject to contract" provision. Parties should consider the intended meaning of each of the clauses of their contract and ensure that the drafting reflects the intentions behind them.

Looked at from a different standpoint, *RTS Flexible Systems Limited* (like the *BSkyB* case), highlights the need for caution during negotiations so that arrangements which are intended to be "subject to contract" remain so. Although clear evidence is required before parties will be held to have waived a "subject to contract" condition, it is important to consider whether statements or conduct could be interpreted to this effect, giving rise to a binding contract without the condition having been satisfied.

### Further information

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