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Court gives guidance on “Subject to Contract” Clauses: By Keith Krut

RTS Flexible Systems Limited (Respondents) v Molkerei Alois Müller GmbH & Company KG (UK Production) (Appellants) [2010] UKSC 14

Although not a shipping case, this judgment of the Supreme Court is of general interest for its discussion of the effect of commonly used “subject to contract” clauses where the parties begin work before finally agreeing the terms of the contract between them.

The parties signed a letter of intent dated 21 February 2005 for the supply by RTS to Müller of specialised equipment. The letter of intent was initially valid for four weeks, during which time it was contemplated that the parties would agree “full contractual terms”. Prior to the four week period expiring, RTS began works. The parties continued to negotiate a final agreement based on certain terms known as the “MF/1” terms, and agreed the purchase price and various schedules. After the expiry of the letter of intent, a final draft of the contract was prepared on 5 July 2005. However this final draft was still not signed by the time the dispute arose between the parties. Clause 48 of the general terms and conditions in Schedule 1 of the MF/1 terms was a “subject to contract” clause which provided that the contract would not become effective until each party had executed a counterpart and exchanged it with the other.

Although some points of the MF/1 terms had not been finally negotiated, the court held that these were not sufficient in themselves to prevent a contract coming into force. The issue before the court therefore was whether clause 48 had this effect. This was important as the MF/1 terms contained provisions relating to liquidated damages and limitations of liability.

Müller argued that clause 48 had the effect that the written contract on MF/1 terms was not enforceable because it was never signed. Nevertheless, Müller contended, a contract existed, on the basis that Müller would pay the agreed price in return for the goods and services that RTS had agreed to provide as set out in a number of schedules to the (unsigned) contract. However, the MF/1 terms were not a part of this contract. This argument originally succeeded in the High Court and was appealed by RTS.

RTS submitted first that there was no contract, alternatively that if there was a contract, it was on terms including the MF/1 terms. The Court of Appeal had allowed RTS’s appeal, holding that clause 48 had prevented any contract between the parties from coming into existence.

However the Supreme Court considered that this made no commercial sense, as all the relevant terms (including the price) had been agreed by or on 5 July, the parties had proceeded with works and stage payments, and had even subsequently varied the contract in important respects on 25 August. Therefore, to hold that clause 48 had prevented a contract from coming into existence was unconvincing.



The Supreme Court also rejected Müller’s contention that a contract had come into being by conduct on the basis of some but not all of the MF/1 terms, but incorporating the schedules to the contract. The Supreme Court reasoned that if clause 48 prevented the MF/1 terms from coming into effect, it must have had the same effect on the schedules.

The Supreme Court then held that on the facts of this case the only inference that made commercial sense was that the parties had agreed to waive the “subject to contract” provision set out in clause 48, and that the agreement between them was legally binding.

This case demonstrates the perils of beginning work without first agreeing the basis upon which it is to be done. As Lord Clarke warned, the moral of the story is “to agree first and start work later”.

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