

## 'Subject to contract': it's not what you say, it's what you do...

By Stephen Brett, Solicitor  
Anderson & Company  
[www.andlaw.eu](http://www.andlaw.eu)

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### Introduction

Early in 2010, in the case of *RTS v Muller*, the Supreme Court considered whether using the phrase 'subject to contract' during contract negotiations prevented an enforceable contract from being formed. The Supreme Court emphasised that conduct is a significant and sometimes crucial factor in assessing whether or not a contract has been formed. This update looks at that decision and some other related decisions and considers the lessons that can be learned from them.

### *RTS v Muller* (Supreme Court, March 2010)<sup>1</sup>

RTS supplies automated machinery to the food handling trade and Muller is well known as a dairy product supplier in Europe. RTS agreed to install and commission automated pot mixing lines and a de-palletising cell at Muller's yoghurt plant in Market Drayton. The parties agreed a letter of intent in March 2005 with the intention that this would expire and be replaced by a detailed final contract in May 2005. Work started. By July 2005, the parties had agreed on most but not all of the major issues. The draft was described as 'subject to contract' and also included a counterpart clause that required each party to execute a counterpart copy and to exchange these copies before the agreement would become effective. In fact, the draft was never signed in any form. A dispute developed over the work that had been done and Muller refused to pay RTS.

The Supreme Court held that whether or not there was a binding contract in place could be established by considering the communication, by words and by conduct, between the parties and assessing whether it led to the objective conclusion that the parties intended to create legal relations and whether they had agreed on all terms essential to form a contract. Indeed, it would be entirely possible to conclude that a contract existed even where the parties had not yet agreed on all the terms that they considered to be commercially significant – for example if the parties' words and conduct showed that the outstanding terms although significant were not a pre-condition to a legally binding agreement.

Applying that reasoning to the facts of the case, the Supreme Court concluded that the July 2005 "draft" represented an agreement between the parties on all the terms that the parties considered

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<sup>1</sup> *RTS Flexible Systems Ltd v Molkerei Alois Muller GmbH & Co KG* [2010] UKSC 14

were essential and, vitally, that the parties' conduct had waived the requirement in the counterpart clause that copies be signed and exchanged. The parties' conduct showed that there was a binding agreement in place, regardless of the use of the phrase 'subject to contract' in the July 2005 draft. As Lord Clarke commented, the case demonstrated the "perils of beginning work without agreeing the precise basis upon which it is to be done".

*Investec v Zulman* (Court of Appeal, May 2010)<sup>2</sup>

Mr Zulman senior and Mr Zulman junior ran a confectionary business in Corby. The business approached Investec for further finance and Mr Zulman senior provided a guarantee to Investec against the business's borrowing. Amendments to the initial terms were discussed and agreed orally but the draft amended guarantee was never signed. As a result, there was a dispute over whether or not Investec could enforce the guarantee on the amended (but not signed) terms or whether it was restricted to relying on the original terms of the guarantee.

The Court of Appeal took the view that it was "important not to over-emphasise the actual phrase "subject to contract"." In every case it was a question whether or not the parties intended to be bound before signature of the relevant document or whether the relevant document was simply a record of an oral agreement and a good guide to the parties' intentions is the terms of the draft documents. The use of the phrase 'subject to contract' is often used as shorthand to indicate an absence of intention to be bound until the relevant document is signed but "its absence does not necessarily mean an intention to be bound once oral agreement is reached".

On the facts of the case, Zulman did not intend to be bound until the amendment document was signed. As it was not signed, the amendments did not apply.

*Immingham Storage v Clear plc* (Court of Appeal, February 2011)<sup>3</sup>

Immingham provided fuel storage facilities. Clear was a fuel commodities trader. Clear approached Immingham regarding storing 4000 cubic metres of fuel. There was a site visit and emails were exchanged. One of these emails attached a quotation headed with the words "Subject to board approval and tankage availability" and referred to a formal contract following in due course. The quotation was accepted and Immingham posted a formal contract for signature. As it happened, Clear wasn't able to source any fuel and did not sign or return the contract papers. Immingham claimed payment. Clear argued that no contract had been formed.

The Court's view was that there was a contract. Immingham's quotation was provided subject to two conditions which needed to be satisfied before the contract proceeded. These were satisfied as board approval and tank availability were quickly confirmed. However, the reference to a formal contract did not amount to a condition that had to be satisfied before a contract was formed. The documents were not headed 'subject to contract'. In fact, the terms and conditions that were provided by Immingham allowed for a contract to come into being once fuel was delivered whether or not the contract had been signed. The email exchanges between the parties clearly indicated that the parties had intended a contract to exist based on the terms of the quotation. Taking all these factors together, the Court concluded that a contract existed based on the quotation and the email

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<sup>2</sup> *Investec Bank (UK) Ltd v Zulman and another* [2010] EWCA Civ 536

<sup>3</sup> *Immingham Storage Co Ltd v Clear plc* [2011] EWCA Civ 89

exchanges. Clear's failure to sign or return the formal contract at a later stage did not prevent a contract from existing.

Summary – what lessons can be learned?

These three cases show that starting work in advance of agreeing a contract is always risky:

- *Immingham v Clear* shows that failing to sign a contract at the last minute after accepting a quotation and exchanging positive emails will not stop a contract from being formed.
- *Investec v Zulman* cautions against putting too much weight behind the phrase 'subject to contract'. It is the parties' intention that matters. The presence or absence of the phrase will not of itself determine whether or not a contract exists.
- *RTS v Muller* illustrates that an agreement can be formed where the parties have agreed on the major issues and started work – even though details remain outstanding and the final agreement has not been signed.

Lord Justice Clarke advises that it is best "to agree first and to start work later". He is undoubtedly right, but it is not always possible to delay starting work until a contract has been drawn up and agreed. If you must take the risk by starting work without the protection of an agreed contract then remember:

- It is vital that it is clear which terms have been agreed and which are outstanding. If you do not accept any proposed term, say so and take special care not to do anything that might be taken to show that you have accepted the position.
- It is not necessary to have a written agreement for there to be a binding contract. If there is to be a written document, be clear whether it is simply a record of what has been agreed or whether there is no agreement until the document has been finalised and signed.
- If the intention is that no agreement will exist until the written document has been finalised and signed, then it will be very risky to start work before finalising the written agreement.
- The phrase 'subject to contract' does not have magical powers. The courts will take more notice of what you do than of what you say when they try to establish whether or not a binding contract exists.

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