Hilary Term
[2010] UKSC 14
On appeal from: [2009] EWCA Civ 26

JUDGMENT

RTS Flexible Systems Limited (Respondents) *v* Molkerei Alois Müller Gmbh & Company KG (UK Production) (Appellants)

before

Lord Phillips, President
Lord Mance
Lord Collins
Lord Kerr
Lord Clarke

JUDGMENT GIVEN ON

10 March 2010

Heard on 2 and 3 December 2009

Appellant
Kenneth MacLean QC
Michael Fealy
(Instructed by Pinsent Masons LLP)

Respondent
Stuart Catchpole QC
Charles Manzoni QC
(Instructed by Addleshaw Goddard LLP)

LORD CLARKE (delivering the judgment of the court)

Introduction

1. This is the judgment of the court. The appeal arises out of a dispute between RTS Flexible Systems Limited ('RTS') and Molkerei Alois Müller GmbH & Co KG ('Müller') in relation to work carried out and equipment supplied by RTS to Müller. The different decisions in the courts below and the arguments in this court demonstrate the perils of beginning work without agreeing the precise basis upon which it is to be done. The moral of the story to is to agree first and to start work later. The claim was brought by RTS for "money due under a contract, alternatively damages". A number of issues arose between the parties and by an order dated 11 January 2008 Akenhead J ordered the trial of specific preliminary issues. That trial came before Christopher Clarke J ('the judge') and on 16 May 2008 he handed down a judgment in which he determined each of them.

2. The parties had initially intended to enter into a detailed written contract which would set out all the complex terms on which the work was to be carried out and the equipment supplied. However, as often happens, the terms were not finalised before it was agreed that work should begin. It was common ground before the judge that the parties entered into a contract formed by a Letter of Intent dated 21 February 2005 and a letter from RTS dated 1 March 2005 ('the LOI Contract'), the purpose of which was to enable work to begin on agreed terms. The judge held that the LOI Contract was treated by the parties as expiring on 27 May 2005. The judge further held that after the lapse of the LOI Contract the parties reached full agreement on the work that was to be done for the price that they had already agreed, which was £1,682,000 and had been agreed in the LOI Contract. He held that the natural inference from the evidence was that their contract was that RTS would carry out the agreed work for the agreed price. It was not however essential for them to have agreed the terms and conditions and they did not do so. They continued after the expiry of the LOI Contract just as they had before, by calling for and carrying out the work without agreement as to the applicable terms. The judge declined to hold that the parties' contract included the final draft version of certain terms known as the MF/1 terms (the 'MF/1 terms').

3. RTS appealed to the Court of Appeal. At the outset of his judgment Waller LJ, with whom Moses LJ and Hallett LJ agreed, made it clear that RTS had said that it was not appealing any of the judge's findings of fact. The issue before the Court of Appeal was whether the judge was right in holding that there was a contract between the parties at all after the expiry of the LOI Contract and

whether, if there was a contract, he was right in holding that it was not on the MF/1 terms. Waller LJ also made it clear that there was an issue as to whether RTS was entitled to contend that there was no contract. The Court of Appeal allowed the appeal and made a declaration that the parties did not enter into any contract after the LOI Contract came to an end.

4. The essential issues in this appeal, which is brought by permission given by the House of Lords, are whether the parties made a contract after the expiry of the LOI Contract and, if so, on what terms. As to terms, the argument centres on whether the contract was subject to some or all of the MF/1 terms as amended by agreement. Müller submits that the judge was correct to hold, both that there was a contract after the expiry of the LOI Contract, and that it was not on any of the MF/1 terms, whereas RTS submits that the Court of Appeal was right to hold that there was no contract but that, if there was, it was on all the MF/1 terms as amended in the course of negotiations. The importance of the MF/1 terms is that they contain detailed provisions as to many matters, including liquidated damages. In this judgment we will focus on those two issues, although part of Müller's challenge to the decision of the Court of Appeal that there was no contract is a submission that it should not have permitted RTS to take the point because it had not been taken before the judge. We will refer briefly to that issue en passant.

The relevant facts

5. Both the judge and Waller LJ have set out the background facts in considerable detail. It is only necessary to refer to some of the facts in order to resolve the issues in this appeal.

6. We begin with the Letter of Intent, which was dated 21 February 2005 and sent by Müller to RTS, and which included the following:

> "**Project: Build, delivery, complete installation and commissioning by RTS … of the Automated Pot Mixing Lines 1 & 2 and the De-Palletising Cell ('the Equipment') for the Repack line ('Repack Line') within the Repack facility in Market Drayton of … Müller …**
>
> Thank you for your mail dated 16 February 2005 setting out your offer (number FS04014 – Issue J) to supply the Equipment to Müller ("the Offer").

> Please accept this letter of intent as confirmation of our wish to proceed with the Project as set out in the Offer subject to the following terms:-
>
> (i) The agreed price for the engineering, build, delivery, installation and commissioning as set out in the Offer is GBP 1,682,000 …
>
> (ii) RTS is now to commence all work required in order to meet Müller's deadlines set out in the Offer to allow commencement of full production by Müller on the Repack Lines by 30 September 2005. Delivery of line also to be in accordance with the timetable set out in the Offer.
>
> (iii) That the full contractual terms will be based on Müller's amended form of MF/1 contract and the full terms and the relevant technical specifications will be finalised, agreed and then signed within 4 weeks of the date of this letter. Prior to agreement on the full contractual terms, only Müller shall have the right to terminate this supply project and contract. However, should Müller terminate, Müller undertakes to reimburse RTS for the reasonable demonstrable out of pocket expenses incurred by RTS up to the date of termination. Müller will not be liable for any loss of profits (whether direct or indirect), loss of contracts, loss of anticipated savings, data, goodwill and revenue or any other indirect or consequential loss arising from such termination. No further legal rights or remedies shall be available to RTS upon such termination.
>
> Please confirm your acceptance of the above by signing below where indicated.
>
> This letter of intent shall be governed by English law and subject to the exclusive jurisdiction of English courts."

It is important to note that the Letter of Intent provided for the whole agreed contract price and was not limited to the price of the works to be carried out during the currency of the LOI Contract. It is also of interest and, we think, of some importance that it was contemplated from the outset that the full contract terms were to be based on Müller's MF/1 terms.

7. On 1 March RTS wrote to Müller confirming that it had started work subject to Müller accepting two points. The first was that the equipment would be

commissioned by 30 September and would be ready for Site Acceptance Testing ('SAT') activities as shown in the programme. But the equipment would not then be expected to be at *full* production quantities. Section (ii) of the Letter of Intent would be revised by omitting "full". The second point referred to section (iii) and made the point that during the four week period covered by the Letter of Intent RTS would incur costs in both engineering time and in order to meet the project programme. It would for example place orders for long lead items such as robots, conveyors and tray erectors. RTS said that, in the event of termination, it would require reimbursement for these costs, including the cancellation costs of subcontract commitments as well as any out of pocket expenses, albeit without profit. Those points were subsequently accepted by Müller.

8. The judge held at his para 39 that it was implicit in the LOI Contract that upon expiry of the four weeks it would come to an end. Neither party challenged his conclusion that after the expiry of the LOI Contract it was not revived, either in the Court of Appeal or in this court. In answering the question posed under Issue 1.1, namely what were terms of the LOI Contract and the obligations of the parties under it, the judge said this at para 42:

> "a) The agreed price for the engineering, build, delivery, installation and commissioning of the work set out in the Quotation was to be £1,682,000;
>
> b) RTS was bound to embark on such work as was necessary to ensure the provision of the equipment to be supplied by it in accordance with the provisions of sections 4 - 8 of Quotation J and the timetable set out in Appendix 7 thereof. Commissioning was to be completed by 30 September 2005 and the equipment was to be ready for production (but not full production) and Site Acceptance Testing as shown in that Appendix at that date;
>
> c) Müller and RTS were to have a period of four weeks from 21 February 2005 to finalise, agree and sign a contract based on Müller's amended MF/1 form of contract. Following the expiry of that period the contract would terminate;
>
> d) Prior to agreement of the full contractual terms and conditions based on Müller's amended MF/1 contract, only Müller had the right to terminate the supply project;

e) If Müller did so terminate or the term of the contract expired, it would reimburse RTS for the reasonable, demonstrable out of pocket expenses incurred by RTS up to the date of termination, including the cost of engineering time, cancellation costs of subcontract commitments, and any out of pocket expenses, but without profit;

f) RTS would have no further legal right or remedy on termination and Müller would not be liable for any loss of profit (whether direct or indirect), loss of anticipated savings, data, goodwill and revenue or any other indirect or consequential loss arising from termination;

g) There were no exclusions or limitations of liability in the contract."

9. It is important to note the references to the MF/1 terms both in the Letter of Intent and in the judge's conclusions. It seems to us to be almost inconceivable that the parties would have entered into an agreement for the performance of the whole project which was not based on detailed terms. The judge made this point at para 39 in these terms:

> "The absence of agreed full contractual terms would be of limited significance over a four week period; but more significant, if it could continue until the end of the project. The parties did not, in my judgment, contemplate that, in the absence of finalisation and signature within the specified timescale (or any agreed extension), RTS would be bound to continue with a project for which the applicable terms had not been agreed. Consistent with that the Letter of Intent says nothing about when any part of the price would be payable and gives Müller a right to cancel upon payment only of expenses and cancellation costs - a right that is entirely reasonable during a four week period but inappropriate for a contract for the entire project. The payment schedule in the Quotation does specify a series of percentage payments, but the first of those is the 30% of TCV payable on receipt of order and the Letter of Intent is not an order."

10. It is also important to set the LOI Contract and what happened subsequently in their context. The negotiations had been proceeding for some time. As appears in the Letter of Intent, apart from the price, the parties had been discussing Quotation J and the schedules to it, including Schedule 7. After the LOI Contract

and while work was proceeding in accordance with it, detailed negotiations proceeded. The negotiations up to 16 May are described by the judge at his paras 43 to 47. Mr David Salisbury, the senior Buyer in Müller's purchasing department, sent the first draft of a contract to RTS on 15 March. The scheme of the draft (and each subsequent draft), in which words beginning with a capital letter had defined meanings, was as follows. Clause 1 provided that on receipt of an Order for Delivery RTS would supply the Equipment and perform the Works on the terms and conditions set out in the Contract and that without prejudice to the other provisions of the Contract the Equipment would comply with the Specification. Clause 2 provided for some terms to survive Termination. Clause 3 provided that Müller would procure payment of the Contract Price as set out in Schedule 2 and, importantly, clause 4 provided that the general terms and conditions set out in Schedule 1 would apply to the Contract. We have not been shown Schedule 2, which may indeed not exist. However, clause 49, which is a definitions clause which was expressly given contractual force by clause 7, included the definition of the Contract Price as £1,682,000 "being the price as set out in more detail in Schedule 1." Clause 5 was entitled Limitation of Liability and provided for limitations of liability referable to particular clauses of the Contract. Clause 6 provided for the following order of preference to be applicable to the contractual documents: first the general terms and conditions set out in Schedule 1, secondly the User Requirement Specification ('URS') set out in Schedule 4, thirdly the Functional Design Specification ('FDS') set out in Schedule 3 and finally all the other Schedules comprised in the Contract.

11. Clauses 8 to 48 were entitled "Schedule 1 General Conditions" and, in their original form, in essence set out the MF/1 terms. It is plain that they were always intended to form an important part of the contract. They were given pride of place by clause 6. In the course of the negotiations they were amended in significant respects. We were provided with a version of the draft contract which shows the original draft in black with subsequent variations in six other colours. In the form of clauses 8 to 48, Schedule 1 included detailed provisions on all the topics one might expect, including Equipment and Services to be Provided, Purchaser's Obligations, the Contract Price, Payment, Warranties, Guarantees, representation and management, Inspection and Testing, Completion, Delay, Defects Liability, Limitations of Liability, Force Majeure and the like. In the course of argument we were referred to many of the amendments that were made in the course of the negotiations. To take one example, when read with clause 5, clause 36 contained detailed provisions (as amended) limiting liability. For example, subject to some exceptions, the limit of each party's liability for an Event of Default is the amount of the Price.

12. Schedule 1 also contained clause 48, which was the subject of considerable debate and provided:

"48. COUNTERPARTS

48.1 This Contract may be executed in any number of counterparts provided that it shall not become effective until each party has executed a counterpart and exchanged it with the other."

13. The draft contract further contained a number of Schedules on various topics to which we refer below. Some but not all of them were referred to in the clauses which formed part of Schedule 1.

14. There were exchanges between the parties as to the terms of the first draft and of the second draft, which was sent to RTS by Mr William Morris, in-house counsel to Müller, on 14 April. One of the proposed changes in that draft was that RTS' parent company, RTS PLC, be added as a guarantor. Meanwhile on 13 April the parties agreed or confirmed their agreement to RTS' letter of 1 March and agreed that the period for execution of a formal contract would expire on 16 May. Negotiations continued and, as the judge noted at para 46, on 13 May Mr Morris e-mailed Mr Gavin Brown, who was RTS' Operations Director, as follows:

"Given that the contract is now almost agreed we hereby confirm that the expiry date for the current letter of intent can be extended until 27 May 2005, or, if sooner, the date the contract is actually signed …"

As stated above, the judge held, in the light of the exchanges between the parties, that they agreed that the LOI Contract would expire on 27 May.

15. Further drafts were sent by Mr Morris to RTS on 11 and 16 May, when, as the judge put it at para 48, Mr Morris e-mailed to Mr Brown the draft "contract with final tweaks", adding "perhaps you can drop me a quick e-mail confirming you are happy – we can then all concentrate on completing the schedules". The draft sent on 16 May was the fourth draft contract. The judge described the schedules sent as part of it at that time in para 48 as follows:

"Schedule 1: General Conditions extending to 48 paragraphs.

Schedule 3: A page headed "*Functional Design Specification*". This is a document which states the intended functionality of the RTS equipment. It is usually

derived from the User Requirement Specification: see below.

Schedule 4: A page headed “User Requirement Specification”. This is usually compiled by the client but, on this occasion, was lifted from RTS' Quotation K at Müller’s request.

Schedule 5: A three page schedule, drafted by Müller, divided into Part 1 “*Tests on Completion*” and Part 2 “*RTS Tests*”.

Schedule 6: A two page schedule, drafted by Müller, headed *Perfor*m*ance Tests*". The last paragraph of this read as follows:

> “THIS SCHEDULE NEEDS TO PROVIDE THAT IF THE TEST WITHIN A CERTAIN PERCENTAGE OF THE REQUIRED LEVEL LDs WILL APPLY AND THE EQUIPMENT WILL STILL HAVE "PASSED". IF THE PERCENTAGE ACHIEVED IS LOWER THAN THAT SPECIFIED BY LDs (I.E. LOWER THAN THE MAXIMUM PAYOUT UNDER LDS) THE EQUIPMENT WILL HAVE FAILED THE TEST AND THE OTHER REMEDIES WILL BE AVAILABLE TO THE PURCHASER”

Schedule 7: An Advance Payment Guarantee to be given by RTS’ parent.

Schedule 8: A defects liability demand guarantee also to be given by RTS’ parent.

Schedule 9: This made provision for the supply of a list of stock items and wear and non-wear parts.

Schedule 10: A description of what the programme needed to include.

Schedule 11: An empty table of Key Performance Indicators, Performance required and Liquidated Damages.

Schedule 12: A page headed "Certificates of Payment" together with a form of Delivery Certificate, Completion Certificate and Final Certificate of Payment.

Schedule 13: A list of the operating manuals and other drawings and maintenance schedules required.

Schedule 14: A Schedule dealing with Training Requirements.

Schedule 15: A Schedule headed "*Health and Safety Requirements*" but otherwise blank.

Schedule 16: A Schedule headed "*Free Issue Equipment*" but otherwise blank.

Schedule 17: A Schedule headed *"Site Preparations*" but otherwise blank."

16. On 19 May Mr Brown e-mailed Mr Morris to say that the fourth draft seemed fine to him except for a small proposed amendment to clause 24.3, which related to delay of Tests on Completion. On 25 May Mr Brown again e-mailed Mr Morris, saying that he expected to have the schedules completed "today". Mr Morris replied saying that the small proposed amendment to clause 24.3 looked fine, but that he needed to get back to him on Force Majeure and "any final tidy-ups". On 26 May Mr Morris made some proposals relating to Force Majeure, to which Mr Brown countered. The judge held at para 50 that on 5 July, after further negotiations, Mr Morris proposed a compromise form of the Force Majeure clause which Mr Brown told him seemed fine and which Mr Morris said he would incorporate into a contract when he put all the schedules together with Müller's Project Manager, Mr St John. He also said that the agreement should be in a position to be signed and forwarded to Mr Brown for signature that week.

17. In the meantime on 26 May Mr Brown had set out RTS' understanding of the current status of the contract schedules in a yet further e-mail to Mr Morris. At para 51, under the heading "*Finalisation of the Schedules*", the judge set out in the form of a kind of Scott schedule both Mr Brown's position from the e-mail under the heading 'Understood status' and his own conclusions with regard to each item under the heading 'My Comment' as follows:

SCH.	Understood status	My Comment
1	Not referred to in the e-mail.	No need. Schedule 1 consisted of the General Conditions.
2	Assumed not required as the payment schedule is included in the body of the contract.	This schedule is described in the Contract as setting out the price; but that is in the General Conditions in Schedule 1 anyway.
3	FDS - currently being reissued. Brown suggested it should be referred to rather than incorporated.	The FDS was later agreed: see the RTS e-mail of 29 June and para 52.
4	URS. Agreed that section 4 of the Quotation would form the URS, which was attached.	The URS had the appendices referred to at para 26.
5	Agreed that RTS Test Plan would form this Schedule. With Müller for approval.	The RTS Test Plan was later agreed: see the RTS e-mail of 29 June: para 52
6	RTS Test Plan	RTS REGARDED ITS TEST PLAN AS COVERING THE GROUND OF SCHEDULES 5 AND 6 AND MÜLLER WAS HAPPY WITH THAT PROVIDED THAT IT DID SO. BUT THE ONLY VERSION OF SCHEDULE 6 CONTAINED MÜLLER'S WORDING.
7	Advance Payment guarantee already agreed.	The guarantee had been attached to the e-mail of 16 May.
8	Defect Liability guarantee - RTS' parent company to approve.	A draft had been attached to the 16 May e-mail. The parent company never approved it.
9	To be completed during the project.	Part 1 related to stock items. It was never completed. Part 2 contains provisions for the durability of Wear Parts, which is capable of standing on its own.
10	Approved programme attached	The attachment was either as in Quotation I or Quotation J. This programme was overtaken by the overall project plan and Installation at Müller plan referred to in para 52 below.

11	KPIs agreed: attached.	These included details of the Performance Required and Liquidated Damages
12	Müller to complete.	This related to Certificates of Payment. Never completed.
13	To be completed during the project.	This related to operating manuals. Never completed, It would not have been possible to provide them at the time.
14	To be completed during the project.	This related to Training Requirements. Never completed
15	Müller to provide details.	This related to Health and Safety Requirements. Never completed
16	As per attached document.	The attached document contained the Assumptions for Free Issue Equipment for the Project
17	Müller to provide site preparation details.	This does not seem to have been provided, but the site was prepared.

The references to para numbers in the Comment boxes are references to para numbers in the judge's judgment. For simplicity we have omitted two footnotes.

18. It can be seen from the Comment boxes that there were no problems about Schedules 1 to 5. As already stated, Schedule 1 was in effect the MF/1 conditions (as amended) and contained clauses 1 to 48. Schedule 2 was unnecessary and, as to Schedules 3, 4 and 5, the FDS, the URS and the RTS Test Plan were variously agreed in the e-mails referred to by the judge. As to Schedule 5, in addition to words to the effect recorded in the judge's Comment box, Mr Brown's email of 26 May went on to suggest that upon approval of the RTS Test plan by Muller "it is included in this schedule and existing text is deleted". On or by 29 June the use of the RTS Test plan in Schedule 5 had been approved by both parties, as recorded in an exchange of emails on that date and by the judge in paragraph 52 of his judgment.

19. Schedule 6 gives rise to more difficulty. Mr Brown's email of 26 May contained simply the words "RTS Test plan" which appear in the judge's Comment box. The words in capitals set out in paragraph 15 above were inserted in the version of Schedule 6 attached to Mr Morris' e-mail of 11 May and also appeared in the version attached to his email of 16 May. The evidence is that those words were originally inserted by Mr Morris as an internal note to his colleagues. However that may be, Schedule 6 was recorded in Mr Brown's e-mail of 26 May as being simply the RTS Test Plan. In the course of his evidence Mr St John confirmed that Müller was content to use the RTS Test Plan as Schedule 6. It is

clear from the judge's entry in his Comment box that he accepted that there was agreement to that effect. That seems to us to be so even though, as he added "the only version of Schedule 6 contained Müller's wording". It appears to us to follow from those conclusions that Schedule 6 comprised, and comprised only, the RTS Test Plan (in a form which was, as we have stated, subsequently agreed as recorded in emails on 29 June), and that the draft or drafts in blue containing the text in capital letters which formed part of the third and/or fourth draft were not agreed as part of Schedule 6. In these circumstances we conclude that by the end of the negotiations there was no issue between the parties as to the content of Schedule 6. We deal further below (para 71 et seq) with Müller's contrary submissions and with the judge's conclusions at para 74 of his judgment on the question whether agreement was reached on Schedule 6 as well as on the related clauses 5 and 27.7 and the relationship between them.

20. We note in passing that it seems to us that the logic that has led us to the conclusion that the RTS Test Plan replaced the draft or drafts of Schedule 6 also leads to the conclusion that it was agreed that the RTS Test Plan entirely replaced the drafts of Parts I and II of Schedule 5 as they appear in our bundle in black and blue respectively. However, this is not a final conclusion because it was not directly addressed in the course of the argument.

21. As to Schedule 7, the form of the Advance Payment Guarantee was agreed but the judge held at para 75 that RTS did not procure the provision of it by its parent company, which was to be the guarantor. As to Schedule 8, RTS' parent company did not approve the Defect Liability Guarantee. As we see it, the judge's comments on Schedules 9 to 17 present no problem. In so far as some items remained to be completed during performance of the project, they seem to us to be items which did not have to be agreed before the contract was made.

22. In para 52 the judge noted that on 29 June, after further discussion, Mr David Guest, who was an RTS Project Manager, e-mailed to Mr Morris copies of the FDS, the Test Plan, the Project Plan and the Installation at Müller plan, which Müller had approved. Mr Guest also e-mailed Mr St John a copy of a detailed Test and Build Schedule. The final version of the draft contract in the coloured version with which we were provided includes the points agreed in the e-mail exchanges of 19 and 25 May, 29 June and 5 July.

23. At para 67 the judge recorded Müller's recognition that the parties reached a final draft of the contractual terms and conditions, namely Schedule 1, which contained the general conditions as modified in the e-mails of 19 and 25 May and 5 July. The judge nowhere rejected Müller's recognition as being wrong on the facts. In our judgment, it was essentially correct. The modifications from the original draft were significant and detailed and were tailored to the particular

project. For example, clause 8.2 included a provision that RTS was not to be held liable for breach of the contract arising from any act or omission of a supplier of the Free Issue Equipment, which was equipment which RTS was not going to design, build or supply but was going to integrate. There are many other examples, including clause 36, which provided, as one would expect, for Limitations of Liability. However, as we see it, with the possible exception of clauses 5 and 27.7, none of the detailed clauses is material to the resolution of the issues in this appeal. In summary, with that possible exception, everything was agreed as at 5 July except for the provisions relating to the parent company guarantee and items which it was not necessary to complete or which were to be completed in the course of the project. We return to this point (and the possible exception) below in the context of the reasoning of the judge.

24. At paras 53 to 61 of his judgment the judge described the performance by RTS, which we can summarise more shortly. RTS began work on the project on 23 February. The expiry of the LOI Contract did not bring that work to an end. Problems arose between June and August with delay to some of the Free Issue Equipment. The project involved the installation of two production lines, Lines 1 and 2. Quotation J and the URS had provided for a Customer Factory Acceptance Test ('CFAT') to be carried out at RTS' premises, after which the equipment was to be installed and commissioned at Müller's factory, followed by a SAT. That programme involved installing Line 2 first. However, as a result of the problems of delay, which are set out in detail at paras 53 to 57 of the judge's judgment, consideration was given to Line 1 being installed before Line 2. As the judge explained at para 58, on 15 August Mr Guest of RTS e-mailed Mr Foster of Müller with a revised schedule for Line 1, which involved the equipment for Line 1 being sent immediately to Market Drayton, without CFAT testing. Under the schedule, low volume production capability was planned as starting on Wednesday 28 September, with SAT beginning on Monday 24 October. This was on the assumption that Line 2 could be installed after Line 1.

25. Discussion of these problems led to a variation of the delivery plans. The judge described the variation as follows:

> "59. On 25 August 2005 there was a meeting to discuss the problem, at which, as is common ground, there was an agreed variation of the delivery plan.
>
> 60. It was agreed that there would be no CFAT at RTS' premises and that Line 1 would be installed first so that production could begin on this Line as soon as it could be made operational once delivered. At the meeting Mr Brown gave Müller certain warnings to which I shall refer hereafter.

> 61. Most of the RTS components for Line 1 were delivered to Müller on or about 5 September 2005. The RTS components for Line 2 were delivered on or about 2 December. Line 1 was run on automatic, for the first time, on 1 October. The 150,000 packs were produced, although much of the production was the result of manual operation without the robots. SAT testing has never taken place. One of the matters in dispute is as to whether it should have done."

26. The judge made further findings as to the variation on 25 August and as to what happened thereafter at paras 106 to 135. It is not necessary to refer to those conclusions in any detail in order to determine the issues in this appeal. However, at para 106 the judge said that it was common ground between the parties that the contract between them was varied on 25 August 2005 at a meeting at RTS' premises in Irlam between Messrs Brown and Guest from RTS and Messrs St John, Benyon, Foster, Highfield and possibly others for Müller, at which the parties agreed to alter the delivery schedules of the lines and to dispense with the need for RTS to conduct CFAT tests on Line 1.

27. After the agreement on 25 August the parties concentrated on Line 1 and Line 2 fell behind. Resources which would otherwise have been dedicated to both Lines had to be dedicated to Line 1 only. Moreover, as the judge held at para 121, the need to deal with Line 1 so as to meet Müller's production requirements seemed to have caused everyone to divert their efforts away from finalising contractual documentation, which was a matter which had gone quiet in mid July. Most of RTS' equipment for Line 1 was delivered on 5 September and detailed work continued on Line 1, which Müller put into production on 10 October.

28. As Waller LJ said at para 43 of his judgment in the Court of Appeal, ultimately a dispute arose between the parties leading to the litigation. The details are unimportant save to comment first that no contract was ever signed as contemplated; second that until argument in the Court of Appeal each party had submitted as its primary position that at some stage a contract came into existence which governed their relationship; but third that both had at different times taken up positions inconsistent with that which they finally adopted at the trial as to whether MF/1 terms formed part of the contract.

29. As to payment, we take the position essentially from Waller LJ's judgment at paras 44 to 46, where he summarised the conclusions of the judge. Müller paid RTS 30 per cent of the agreed price of £1,682,000 plus VAT on about 28 April 2005 and made further payments of 30 per cent on 8 September 2005 and of 10 per cent in January 2006. It did so following the issue by RTS of invoices which claimed those specified percentages of a total contract value of £1,682,000.

Although 30 per cent was specified in Quotation J as the amount of the first two payments under the contract, the payments made were not all stage payments as specified in Quotation J. That Quotation called for (a) 30 per cent on receipt of order, (b) 30 per cent on delivery to RTS of the major items of bought out equipment, (c) 20 per cent on delivery to Müller, (d) 10 per cent on completion of commissioning and (e) 10 per cent within 30 to 90 days of takeover, although (a) was to be within 7 days of receipt of order and (b), (c) and (d) were to be within 30 days of the date of invoice. There was however no order and, even if the Letter of Intent was to be regarded as the equivalent, payment was not made within 7 days of it. The second 30 per cent was paid after delivery to RTS of major items and submission of an invoice. The 10 per cent paid in January 2006 was not however the 20 per cent due on delivery. Waller LJ further noted that the payments made were not the stage payments specified in clause 11 of the fourth draft of the Contract sent with the e-mail of 16 May.

30. While that is so, the fact remains that the payments were expressly made pursuant to requests by RTS for payment of specific percentages of the Contract Price, which seems to us to support the conclusion that the parties had agreed the Contract Price.

The parties' cases before the judge

31. As stated above, at para 67 the judge recorded Müller's recognition that the parties reached a final draft of the contractual terms and conditions, namely Schedule 1, which contained the general conditions as modified in the e-mails of 19 and 25 May and 5 July. Müller had expressly pleaded in its Contractual Statement of Case (and submitted to the judge) that on 5 July RTS and Müller agreed the terms of the proposed written contract between them and the draft contract was ready for execution. Before the judge Müller's case was that, despite that agreement, there was no binding contract between the parties on those terms for the reasons which the judge summarised at para 67. This was because it was the parties' intention that detailed terms negotiated by them would not have contractual effect until the relevant documentation, namely the Contract and the Schedules, was formally executed and signed. That that was so appeared from:

> "a) the Letter of Intent which referred to the full terms and the relevant technical specifications being finalised, agreed and then signed within 4 weeks of the date of that letter;
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> b) Mr Morris' e-mail of 13 May, which referred to the Letter of Intent lasting until 27 May or, if sooner, the date the contract is "*actually signed*";"

and was consistent with

> "c) the evidence of Mr Brown of RTS, in para 46 of his witness statement, referring to his e-mail of 26 May 2005 that:
>
> > "My view was that whilst we had agreed the wording in principal (sic), until the whole contract including the schedules had been compiled as a complete document and signed as accepted by RTS then it wasn't enforceable. Whether this is right or not I don't now know, but it was what I thought then. Therefore, to my mind, the milestone event at which the terms and conditions of the anticipated contract were agreed and in force was when RTS signed the document."

32. Müller's case was that no contractual document had been signed and thus no such document had been exchanged. Its case was not, however, that there was no contract between the parties. Its case that there was a contract depended upon the fact of payment and the work carried out, including delivery of the components comprising Line 1 on 5 September. There was a contract on the basis that Müller would pay the price, namely £1,682,000, in return for the goods and services that RTS had agreed to provide as set out in a number of specific documents identified by the judge at para 68. The specific documents relied upon by Müller and set out by the judge at para 68 were the following: (i) the documents attached to the e-mail of 26 May, namely (a) the URS and its Appendices, save that the Parent Company guarantee was never given and the Provisional Project Plan was overtaken by the documents set out at para 22 above (and para 52 of the judgment) in June, (b) the KPIs and (c) the Assumptions for Free Issued Equipment ('the Assumptions'); and (ii) the documents attached to Mr Guest's two e-mails of 29 June, namely (a) the FDS, (b) the Test Plan, (c) the overall project plan (which superseded the delivery programme attached to the e-mail of 26 May) which was to form Schedule 10 to the contract, (d) the installation plan and (e) the Test and Build Schedule. In short Müller submitted that the parties had an intention to create contractual relations when RTS provided the goods and services and Müller made its payments.

33. Müller's case was that no further contractual terms as to payment had been agreed, with the result that RTS was not entitled to payment of the balance of the price over and above the amount in fact paid by Müller as set out below until it had completed substantial performance. Moreover, a critical part of Müller's case was that the amended MF/1 terms as agreed and set out in clauses 8 to 48 as amended never became part of a binding agreement.

34. The primary case for RTS before the judge by contrast (as summarised at para 71) was (i) that the LOI Contract incorporated Quotation J, including RTS' standard terms, (ii) that it did not expire in May and (iii) that it was never replaced by any new contract. The judge rejected (i) and (ii), which left RTS' alternative case, which was that, if there was a new contract, it incorporated the agreed amended MF/1 conditions. This was on the basis that if, as Müller submitted, most of the Schedules were incorporated, so also were the terms and conditions in Schedule 1, which was the basis of the contract. We accept Mr Catchpole's submission that before the judge RTS' primary case was that there was a continuing contract on the terms of the LOI Contract, but that it had two alterative cases, namely that there was either no contract (but RTS was entitled to a quantum meruit) or, if there was a contract, that it was on MF/1 terms.

35. We note in passing that preliminary issue 1.2.4 was formulated in such a way that one of the possible results was a right to payment, not under contract but by way of quantum meruit. In these circumstances we agree with the Court of Appeal that, in the light of the submissions before him, it would have been open to the judge to hold that there was no contract but that RTS was entitled to a quantum meruit. As Waller LJ put it at para 55, before the judge could decide what contract had come into existence after the expiry of the LOI Contract, he would have to consider whether a contract came into existence at all. The Court of Appeal was correct to hold that it was open to RTS to submit that there was no contract and we reject Müller's submissions to the contrary. In any event, we detect no injustice in permitting RTS to contend that there was no contract, either in the Court of Appeal or in this court.

The conclusion and reasoning of the judge

36. The judge accepted Müller's submissions. He held at para 72 that after the lapse of the LOI Contract the parties reached full agreement on the work that was to be done "for the price that they had already agreed". Having referred at para 66 to the decision and reasoning of Steyn LJ in *G Percy Trentham Ltd v Archital Luxfer Ltd* [1993] 1 Lloyd's Rep 25 at 27 he said that it was, as Steyn LJ had contemplated, unrealistic to suppose that the parties did not intend to create legal relations. So far so good. However, he held that it was not essential for them to have agreed the terms and conditions, by which we think he meant the MF/1 conditions, and they did not do so. He held that the parties continued after the expiry of the LOI Contract just as they had done before, that is by calling for and carrying out the work without agreement as to the applicable terms. In paras 73 to 76 he gave four reasons for declining to infer that the contract included the final draft version of the MF/1 conditions.

37. The four reasons were these:

i) Müller's Letter of Intent and its e-mail of 13 May 2005 indicated that the final terms were not to be contractually agreed until signature.

ii) The contract sent with the e-mail of 16 May was designed to operate as a composite whole, consisting of (a) the basic two page, seven clause contract, and (b) the 17 schedules that are annexed to it and referred to in the general conditions which constitute Schedule 1. Although many of these Schedules were agreed several were not. In particular it was not agreed what Schedule 6 would contain. The words in capitals represented a proposed, but never agreed, refinement to give Müller some ampler remedy than liquidated damages if the performance of the equipment was lower than that degree of non performance which would give rise to the maximum liquidated damages.

iii) The parties did not proceed on the basis of the conditions. RTS did not procure the provision of the Advance Payment Guarantee (Schedule 7), which, under the conditions, was required to be procured prior to the advance payment being made. Schedules 15 and 17, which address matters relevant from the start of the contract, were not completed. Müller did not appoint an Engineer. Payment was not made in accordance with the application and certification procedure laid down in clause 11 and the procedure for Changes to the Contract laid down by clause 39 was not followed. The dispute procedure required by clause 41 was not followed.

iv) Clause 48 of the general conditions was not satisfied because the contract was not executed, nor were any counterparts exchanged.

38. As we read them, those reasons contain two different strands. The first is set out in reasons i) and iv) and is that any agreement made between the parties was made subject to contract and was not binding until a formal contract was signed by and perhaps exchanged between both parties. The second is set out in ii) and iii) and is that all essential terms were not agreed.

39. For those reasons the judge held that by no later than 29 June 2005 the contract between the parties, which was to apply retrospectively, was that RTS was to provide the goods and services specified, and comply with the obligations set out, in the documents set out in his para 68, subject to the conditions specified therein.

The parties' cases in the Court of Appeal

40. In the Court of Appeal, RTS abandoned its case that the LOI Contract did not expire but continued. It submitted to the Court of Appeal that the judge was wrong to hold that there was a contract on terms which excluded the MF/1 terms. Its submissions were first that there was no contract and, secondly, that, if there was a contract, it was on the terms agreed as at 5 July, which included the MF/1 terms set out in clauses 8 to 48 and the Schedules, as amended by agreement. Müller submitted that the point that there was no contract was not open to RTS. At para 53 Waller LJ said this:

> "53. The force of this argument was clearly not lost on Müller. The major part of their skeleton in the Court of Appeal was aimed at arguing that RTS should not be entitled to argue the point in the Court of Appeal having regard to the stance they had taken before the judge. The answer to the point on its merit was put shortly as follows and in much the same way as the argument had been put before the judge:-
>
> '79. On its proper construction, clause 48 of the amended form MF1 prevented a contract *on those terms* taking effect without signature by the parties and RTS plc. It does not follow that in the absence of a signed agreement there could not be a binding contract between the parties on some other terms as a result of their conduct.'"

41. As we read para 53, Waller LJ is there setting out Müller's skeleton argument. The argument was that, although clause 48 prevented a contract on MF/1 terms, it did not prevent a contract on other terms based on conduct. On that footing Müller sought to uphold the approach taken by the judge.

Conclusion and reasoning of the Court of Appeal

42. The Court of Appeal decided the appeal on a narrow basis. It rejected the submission that it was not open to RTS to contend that there was no contract. It accepted the proposition in the first sentence of para 79 of the skeleton. Waller LJ held at para 56 that the judge had misconstrued clause 48. He added:

> "He relied on condition 48 as preventing a contract coming into being on the MF/1 conditions [see para 76]. This, I understand, to be the point taken by [Müller] at paragraph 79 of their skeleton quoted above. But once it is appreciated that the definition of contract in condition 48 covers not just those conditions but the contract

> including the schedules, condition 48 seems to me to become a complete answer."

We put 'Müller' in square brackets because the copy of the judgment we have refers to RTS. However that is a typographical error because the reference is in fact to Müller's skeleton, as Waller LJ's para 61 states. His reference to 'the definition of contract' is a reference to clause 49, which defined 'Contract' as meaning 'this Contract signed by the parties and the Schedules'.

43. It is of interest to note that at para 58 Waller LJ appreciated that the conclusion that there was no contract could be said to be very unsatisfactory but he added that the judge's answer was also very unsatisfactory in that, although the MF/1 conditions had to all intents and purposes been agreed and the limit of RTS' liability had been agreed, "by selecting simply the schedules [the judge] achieved a bargain neither side intended to enter into". Waller LJ then said this by way of conclusion at para 61:

> "It would, as it seems to me, from the way negotiations had gone as between the parties, and once the true construction of condition 48 has been appreciated, have needed a clear express variation of condition 48 for a court to be able to reach the conclusion which the judge reached, i.e. that all of MF/1 had been put on one side by the parties and the Schedules (and only in so far as they have been agreed) applied. With condition 48 properly understood and in the context of the importance the parties actually considered the negotiations of MF/1 to have, in my view, the above conclusion is simply not open to the court, and I reject Mr Maclean's submissions as encapsulated in paragraph 79 of his written submissions."

44. There was no detailed analysis in the Court of Appeal of the possibility that the preferable conclusion was not either of the solutions which Waller LJ (in our view correctly) rejected but that the parties had by their conduct unequivocally waived clause 48 and that there was a contract on the terms agreed as at 5 July as subsequently varied by the agreement of 25 August.

Discussion

The principles

45. The general principles are not in doubt. Whether there is a binding contract between the parties and, if so, upon what terms depends upon what they have

agreed. It depends not upon their subjective state of mind, but upon a consideration of what was communicated between them by words or conduct, and whether that leads objectively to a conclusion that they intended to create legal relations and had agreed upon all the terms which they regarded or the law requires as essential for the formation of legally binding relations. Even if certain terms of economic or other significance to the parties have not been finalised, an objective appraisal of their words and conduct may lead to the conclusion that they did not intend agreement of such terms to be a pre-condition to a concluded and legally binding agreement.

46. The problems that have arisen in this case are not uncommon, and fall under two heads. Both heads arise out of the parties agreeing that the work should proceed before the formal written contract was executed in accordance with the parties' common understanding. The first concerns the effect of the parties' understanding (here reflected in clause 48 of the draft written contract) that the contract would "not become effective until each party has executed a counterpart and exchanged it with the other" – which never occurred. Is that fatal to a conclusion that the work done was covered by a contract? The second frequently arises in such circumstances and is this. Leaving aside the implications of the parties' failure to execute and exchange any agreement in written form, were the parties agreed upon all the terms which they objectively regarded or the law required as essential for the formation of legally binding relations? Here, in particular, this relates to the terms on which the work was being carried out. What, if any, price or remuneration was agreed and what were the rights and obligations of the contractor or supplier?

47. We agree with Mr Catchpole's submission that, in a case where a contract is being negotiated subject to contract and work begins before the formal contract is executed, it cannot be said that there will always or even usually be a contract on the terms that were agreed subject to contract. That would be too simplistic and dogmatic an approach. The court should not impose binding contracts on the parties which they have not reached. All will depend upon the circumstances. This can be seen from a contrast between the approach of Steyn LJ in the *Percy Trentham* case, which was relied upon by the judge, and that of Robert Goff J in *British Steel Corporation v Cleveland Bridge and Engineering Co Ltd* [1984] 1 All ER 504, to which the judge was not referred but which was relied upon in and by the Court of Appeal.

48. These principles apply to all contracts, including both sales contracts and construction contracts, and are clearly stated in *Pagnan SPA v Feed Products Ltd* [1987] 2 Lloyd's Rep 601, both by Bingham J at first instance and by the Court of Appeal. In *Pagnan* it was held that, although certain terms of economic significance to the parties were not agreed, neither party intended agreement of those terms to be a precondition to a concluded agreement. The parties regarded

them as relatively minor details which could be sorted out without difficulty once a bargain was struck. The parties agreed to bind themselves to agreed terms, leaving certain subsidiary and legally inessential terms to be decided later.

49. In his judgment in the Court of Appeal in *Pagnan* Lloyd LJ (with whom O'Connor and Stocker LJJ agreed) summarised the relevant principles in this way at page 619:

> "(1) In order to determine whether a contract has been concluded in the course of correspondence, one must first look to the correspondence as a whole...
>
> (2) Even if the parties have reached agreement on all the terms of the proposed contract, nevertheless they may intend that the contract shall not become binding until some further condition has been fulfilled. That is the ordinary 'subject to contract' case.
>
> (3) Alternatively, they may intend that the contract shall not become binding until some further term or terms have been agreed...
>
> (4) Conversely, the parties may intend to be bound forthwith even though there are further terms still to be agreed or some further formality to be fulfilled...
>
> (5) If the parties fail to reach agreement on such further terms, the existing contract is not invalidated unless the failure to reach agreement on such further terms renders the contract as a whole unworkable or void for uncertainty
>
> (6) It is sometimes said that the parties must agree on the essential terms and it is only matters of detail which can be left over. This may be misleading, since the word 'essential' in that context is ambiguous. If by 'essential' one means a term without which the contract cannot be enforced then the statement is true: the law cannot enforce an incomplete contract. If by 'essential' one means a term which the parties have agreed to be essential for the formation of a binding contract, then the statement is tautologous. If by 'essential' one means only a term which the Court regards as important

> as opposed to a term which the Court regards as less important or a matter of detail, the statement is untrue. It is for the parties to decide whether they wish to be bound and if so, by what terms, whether important or unimportant. It is the parties who are, in the memorable phrase coined by the Judge [at page 611] 'the masters of their contractual fate'. Of course the more important the term is the less likely it is that the parties will have left it for future decision. But there is no legal obstacle which stands in the way of the parties agreeing to be bound now while deferring important matters to be agreed later. It happens every day when parties enter into so-called 'heads of agreement'.

The same principles apply where, as here, one is considering whether a contract was concluded in correspondence as well as by oral communications and conduct.

50. Before the judge much attention was paid to the *Percy Trentham* case, where, as Steyn LJ put it at page 26, the case for Trentham (the main contractor) was that the sub-contracts came into existence, not simply from an exchange of contracts, but partly by reason of written exchanges, partly by oral discussions and partly by performance of the transactions. In the passage from the judgment of Steyn LJ at page 27 quoted by the judge at para 66 he identified these four particular matters which he regarded as of importance. (1) English law generally adopts an objective theory of contract formation, ignoring the subjective expectations and the unexpressed mental reservations of the parties. Instead the governing criterion is the reasonable expectations of honest sensible businessmen. (2) Contracts may come into existence, not as a result of offer and acceptance, but during and as a result of performance. (3) The fact that the transaction is executed rather than executory can be very relevant. The fact that the transaction was performed on both sides will often make it unrealistic to argue that there was no intention to enter into legal relations and difficult to submit that the contract is void for vagueness or uncertainty. Specifically, the fact that the transaction is executed makes it easier to imply a term resolving any uncertainty, or, alternatively, it may make it possible to treat a matter not finalised in negotiations as inessential. This may be so in both fully executed and partly executed transactions. (4) If a contract only comes into existence during and as a result of performance it will frequently be possible to hold that the contract impliedly and retrospectively covers pre-contractual performance.

51. By contrast, in the Court of Appeal much attention was paid to the decision of Robert Goff J in the *British Steel* case, which had not been cited to the judge. At para 51 Waller LJ said that the factors which influenced Robert Goff J to conclude in that case that there was no binding contract apply with equal force to the factual matrix here. He thought (para 59) that, if the judge had had Robert Goff J's

judgment cited to him (and/or if the no contract point had been fully developed before him) the judge would not have reached the conclusion he did.

52. The particular passage in Robert Goff J's judgment (starting at page 510G) on which Waller LJ relied reads as follows:

> "The real difficulty is to be found in the factual matrix of the transaction, and in particular the fact that the work was being done *pending* a formal sub-contract the terms of which were still in a state of negotiation. It is, of course, a notorious fact that, when a contract is made for the supply of goods on a scale and in circumstances such as the present, it will in all probability be subject to standard terms, usually the standard terms of the supplier. Such standard terms will frequently legislate, not only for the liability of the seller for defects, but also for the damages (if any) for which the seller will be liable in the event not only of defects in the goods but also of late delivery. It is a commonplace that a seller of goods may exclude liability for consequential loss, and may agree liquidated damages for delay. In the present case, an unresolved dispute broke out between the parties on the question whether CBE's or BSC's standard terms were to apply, the former providing no limit to the seller's liability for delay and the latter excluding such liability altogether. Accordingly, when, in a case such as the present, the parties are still in a state of negotiation, it is impossible to predicate what liability (if any) will be assumed by the seller for, eg defective goods or late delivery, if a formal contract should be entered into. In these circumstances, if the buyer asks the seller to commence work 'pending' the parties entering into a formal contract, it is difficult to infer from the [seller] acting on that request that he is assuming any responsibility for his performance, except such responsibility as will rest on him under the terms of the contract which both parties confidently anticipate they will shortly enter into. It would be an extraordinary result if, by acting on such a request in such circumstances, the [seller] were to assume an unlimited liability for his contractual performance, when he would never assume such liability under any contract which he entered into."

(Waller LJ rightly put 'seller' in parenthesis since, although the report reads 'buyer', Robert Goff J must have meant 'seller'.)

53. In that passage Robert Goff J recognised that contracts for the supply of goods on a significant scale will in all probability be subject to standard terms, which will frequently legislate, not only for the liability of the seller for defects, but also for the damages (if any) for which the seller will be liable in the event not only of defects in the goods but also of late delivery. Thus a seller may exclude liability for consequential loss, and may agree liquidated damages for delay. In the *British Steel* case itself there was an unresolved dispute as to whose standard terms were to apply. One set of terms provided no limit to the seller's liability for delay and the other excluded such liability altogether. We can understand why, in such a case, if the buyer asks the seller to commence work 'pending' the parties entering into a formal contract, it is difficult to infer from the seller acting on that request that he is assuming any responsibility for his performance, "except such responsibility as will rest on him under the terms of the contract which both parties confidently anticipate they will shortly enter into". By the last words, Robert Goff J was not suggesting that there was, in the case before him, any contract governing the performance rendered, merely that the parties had anticipated (wrongly in the event) that there would be.

54. There is said to be a conflict between the approach of Steyn LJ in the *Percy Trentham* case and that of Robert Goff J in the *British Steel* case. We do not agree. Each case depends upon its own facts. We do not understand Steyn LJ to be saying that it follows from the fact that the work was performed that the parties must have entered into a contract. On the other hand, it is plainly a very relevant factor pointing in that direction. Whether the court will hold that a binding contract was made depends upon all the circumstances of the case, of which that is but one. The decision in the *British Steel* case was simply one on the other side of the line. Robert Goff J was struck by the likelihood that parties would agree detailed provisions for matters such as liability for defects and concluded on the facts that no binding agreement had been reached. By contrast, in *Pagnan* Bingham J and the Court of Appeal reached a different conclusion, albeit in a case of sale not construction.

55. We note in passing that the *Percy Trentham* case was not a 'subject to contract' or 'subject to written contract' type of case. Nor was *Pagnan*, whereas part of the reasoning in the *British Steel* case in the passage quoted above was that the negotiations were throughout conducted on the basis that, when reached, the agreement would be incorporated in a formal contract. So too was the reasoning of the Court of Appeal in *Galliard Homes Ltd v J Jarvis & Sons Ltd* (1999) 71 Con LR 219. In our judgment, in such a case, the question is whether the parties have nevertheless agreed to enter into contractual relations on particular terms notwithstanding their earlier understanding or agreement. Thus, in the *Galliard Homes* case Lindsay J, giving the only substantive judgment in the Court of Appeal, which also comprised Evans and Schiemann LJJ, at page 236 quoted with approval the statement in *Megarry & Wade, The Law of Real Property*, 5th ed

(1984) at pages 568-9 that it is possible for an agreement 'subject to contract' or 'subject to written contract' to become legally binding if the parties later agree to waive that condition, for they are in effect making a firm contract by reference to the terms of the earlier agreement. Put another way, they are waiving the 'subject to [written] contract' term or understanding.

56. Whether in such a case the parties agreed to enter into a binding contract, waiving reliance on the 'subject to [written] contract' term or understanding will again depend upon all the circumstances of the case, although the cases show that the court will not lightly so hold. We turn to consider the facts.

Application of the principles to the facts

57. There are three possible conclusions which could be reached. They are (1) that, as the Court of Appeal held, there was no contract between the parties; (2) that, as the judge held, there was a contract between the parties on the limited terms found by the judge; and (3) that there was an agreement between the parties on wider terms. In the third case there is some scope for argument as to the precise terms. As appears below, it is our view that, if the third solution is adopted, the most compelling conclusion is that the terms were those agreed on and before 5 July as subsequently varied on 25 August. We consider each possible conclusion in turn.

(1) No contract

58. We agree with the judge that it is unrealistic to suppose that the parties did not intend to create legal relations. This can be tested by asking whether the price of £1,682,000 was agreed. Both parties accept that it was. If it was, as we see it, it must have formed a part of a contract between the parties. Moreover, once it is accepted (as both parties now accept) that the LOI Contract expired and was not revived, the contract containing the price must be contained in some agreement other than the LOI Contract. If the price is to be a term binding on the parties, it cannot, at any rate on conventional principles, be a case of no contract. Although it did not address this question, the Court of Appeal's solution involves holding that there was no binding agreement as to price or anything else and that evidence of the agreed price is no more than some evidence of what a reasonable price would have been for quantum meruit purposes. The difficulty with that analysis seems to us to be threefold. First, neither party suggested in the course of the project that the price was not agreed and RTS invoiced for percentages of the price and Müller paid sums so calculated as described above. Second, the price of £1,682,000 was agreed and included in the LOI Contract on the footing that there would be a detailed contract containing many different provisions including, as expressly

recognised in the LOI Contract, the MF/1 terms. Third, there was an agreed variation on 25 August which nobody suggested was not a contractual variation.

59. In these circumstances the no contract solution is unconvincing. Moreover, it involves RTS agreeing to proceed with detailed work and to complete the whole contract on a non-contractual basis subject to no terms at all.

(2) Contract on the terms found by the judge

60. We entirely agree with the judge that the parties initially intended that there should be a written contract between them which was executed by each and exchanged between them. We further accept that, if the matter were tested on, say, 5 July, the correct conclusion may well have been that that remained the position and that there was no binding agreement between them. However, that is not on the basis that the parties had not reached agreement (or sufficient agreement) but because the agreement they had reached remained (in the traditional language) 'subject to contract'. Thus, as correctly submitted in Müller's skeleton argument before the judge, the agreement was ready for execution at that stage but was subject to contract. In the same skeleton argument Müller correctly submitted that the question was, objectively speaking, whether the parties' intentions took a new turn at some stage such that they intended to be bound by the 'final draft contract' without the need for its formal execution. As we read it, the skeleton defined the 'final draft contract' as the draft sent by Mr Morris on 16 May, subject to subsequent e-mail agreement as stated above.

61. The striking feature of this case which makes it very different from many of the cases which the courts have considered is that essentially all the terms were agreed between the parties and that substantial works were then carried out and the agreement was subsequently varied in important respects. The parties treated the agreement of 25 August as a variation of the agreement that they had reached by 5 July. Nobody suggested in August that there was no contract and thus nothing to vary. It was not until November, by which time the parties were in dispute, that points were taken as to whether there was a contract.

62. We have reached the firm conclusion that by 25 August at the latest the parties' communications and actions lead to the conclusion that they had agreed that RTS would perform the work and supply the materials on the terms agreed between them up to and including 5 July as varied by the agreement of 25 August. Thereafter the work continued on a somewhat different basis because of the provision of Line 1 before Line 2. As stated above, it does not seem to us to make commercial sense to hold that the parties were agreeing to the works being carried out without any relevant contract terms. In this regard we agree with the judge.

63. On the other hand it does not seem to us to make commercial sense to hold that the work was carried out on some but not all the terms agreed by 5 July. The terms were negotiated on the basis that the Schedules would form part of the Contract, which also contained the detailed Conditions in Schedule 1, which had themselves been subject to much discussion and comprised clauses 8 to 48. We accept Mr Catchpole's submission that the Conditions, based as they were on the MF/1 terms which were put forward by Müller and expressly referred to in the LOI Contract and which (among many other things) defined RTS' performance obligations, set out the warranties provided by RTS and identified the limit of its potential liability. It is, in our judgment, inconceivable that the parties would have agreed only some of the terms, namely those in the specific documents identified by Müller, and not those in clauses 8 to 48. It seems to us that this was one of the considerations which the Court of Appeal had in mind in reaching the extreme conclusion which it did, namely that there was no contract at all.

64. We agree with the Court of Appeal that the judge's analysis cannot be correct. As appears from paras 36 and 37 above, there were four reasons for his decision, expressed in para 72, not to infer that the contract included the final draft version of the MF/1 conditions. They were expressed in his paras 73 to 76. His first and fourth reasons appear to us to be essentially the same. As to his first reason, it is true that the LOI Contract and the e-mail of 13 May indicated that the final terms were not to be contractually agreed until signature. That was indeed the original plan and remained the position until after 5 July. Equally, his fourth reason was that the effect of clause 48 was that the contract was not to be binding until signed.

65. The problem with these conclusions is that, as Mr Catchpole submitted, they prove too much. Given that no formal contract was signed or exchanged, we accept that, unless and until the parties agreed to vary or waive clause 48, the Contract would not become binding or effective. The problem for Müller is that identified by the Court of Appeal. Given the definition of 'Contract' in clause 49 as including the Schedules, the effect of clause 48 would be that the Schedules would be as ineffective as the MF/1 conditions because they all form part of the Contract as defined. Yet Müller's case is that the documents identified by the judge as forming the terms of a binding agreement are all or almost all 'Schedules' within the meaning of clause 49. It follows that, if clause 48 prevented the MF/1 terms from being binding terms of a contract, by parity of reasoning it prevented the documents relied upon by Müller (and accepted by the judge) from being binding terms either.

66. It follows that, subject to one point, we agree with the reasoning of the Court of Appeal in paras 56 and 61 of Waller LJ's judgment and referred to above. That one point is this. Waller LJ said that it would have required a

> "clear express variation of condition 48 for a court to be able to reach the conclusion which the judge reached, i.e. that all of MF/1 had been put on one side by the parties and the Schedules (and only in so far as they have been agreed) applied." (para 61)

We can well understand that, given the Court of Appeal's conclusion that, for the reasons discussed above, there could have been no contract on the terms found by the judge if clause 48 (or the 'subject to contract' understanding embodied in it) remained, the court would have no alternative but to hold that there was no contract. That is not, however, so if the parties have by their exchanges and conduct waived the 'subject to contract' condition or understanding.

67. We agree with the Court of Appeal that, before it could be held that there was a binding contract on the MF/1 terms as amended by agreement, unequivocal agreement that clause 48 had been waived would be required. We do not however think that it is necessary for that agreement to be express if by that is meant an express statement by the parties to that effect. Such unequivocal agreement can in principle be inferred from communications between the parties and conduct of one party known to the other.

68. If such an inference can be drawn on the facts, then the correct solution would not be the second but the third of the possibilities identified above, subject to the judge's second and third reasons identified in para 37 above. It would not, in our opinion, be the second possibility because that would involve holding that the parties agreed some but not all of the terms agreed on or before 5 July. Yet, as the judge held at his para 74 (our para 37ii)), the contract sent with the e-mail of 16 May was designed to operate as a composite whole, consisting of (a) the basic two page, seven clause contract and (b) the 17 schedules that are annexed to it and referred to in the general conditions which constitute Schedule 1, that is the MF/1 terms. In our judgment, the parties at no time reached agreement on the terms set out in the documents referred to in the judge's para 68 without the MF/1 terms as amended, which form an important part of the Contract, namely clauses 8 to 48.

(3) Contract on terms wider than found by the judge

69. The first question under this head is whether the parties departed from the understanding or agreement that it was to be subject to contract, as had been the original understanding of the parties and as expressly provided in clause 48. The second is whether the parties intended to be bound by what was agreed or whether there were further terms which they regarded as essential or which the law regards as essential in order for the contract to be legally enforceable. It is convenient to consider the second point first.

All essential terms agreed?

70. The second point is embodied in the judge's paras 74 and 75 and is set out in para 37ii) and iii) above. We entirely agree with the judge's conclusion in the first sentence of our para 37ii) that the fourth draft of the contract sent with the e-mail of 16 May was designed to operate as a composite whole consisting of the two page seven clause contract and clauses 8 to 48 which comprised the MF/1 terms as amended and the 17 Schedules annexed. We have set out the facts in this regard in some detail at paras 11 to 30 above. In summary, the parties negotiated clauses 8 to 48 in some detail and, subject to some of the Schedules, the clauses were essentially agreed. As noted at para 23 above, at his para 67 the judge recorded Müller's recognition that the parties reached a final draft of the contractual terms and conditions, namely Schedule 1, which contained the general conditions as modified in the e-mails of 19 and 25 May and 5 July. The judge nowhere rejected Müller's recognition as being wrong on the facts. That draft is the version with coloured amendments up to purple in the version provided to us.

71. As to the Schedules, the judge recognised at his para 74 (our para 37ii) and iii)), that although many of the Schedules were agreed, several were not. In particular, he said that it was not agreed what Schedule 6 would contain and that the words in capitals represented a proposed, but never agreed, refinement to give Müller some ampler remedy than liquidated damages if the performance of the equipment was lower than that degree of non performance which would give rise to the maximum liquidated damages. We have already expressed the view in para 19 above that, on the judge's findings of fact, the parties had agreed that Schedule 6 would comprise, and comprise only, the RTS Test Plan.

72. We return to Mr Maclean's submissions that (a) the parties had not reached agreement on the suggestion contained in the capital letters in the text of the fourth draft quoted above and that, absent such agreement, there could be no binding agreement between the parties and/or (b) clauses 5 and 27.7 were not or cannot be taken as having been agreed.

73. Clause 5 provided for limits of liability in relation to specific clauses. In relation to clause 27.7, as amended by Müller in blue, as shown in italics below, and sent to RTS with the third draft it provided:

> "Percentage of Contract Price to be paid to the Purchaser or deducted from the Contract Price *[words deleted] [to be calculated in accordance with Schedule 6]*.

Maximum percentage of Contract Price for which liquidated damages payments paid under clause 27.7.2 is 2.5%.

74. Clause 27.7.1 and 2 provided:

> "27.7 If the Works fail to pass the Performance Tests *[words deleted] as determined by the provisions of Schedule 6* above then the following remedies will be available to the Purchaser:-
>
> 27.7.1 the Contractor shall (without prejudice to the Purchaser's other rights and remedies) pay to the Purchaser *[words deleted]* the sum set out in clause 5 *[words deleted]* within 14 days of receipt of an invoice from the Purchaser such sum being agreed between the parties as being a genuine pre-estimate of losses suffered by the Purchaser as a result of *the Equipment not meeting the requisite standards*;
>
> 27.7.2 where the Purchaser has *not* become entitled to liquidated damages due to the Performance Tests not being successfully passed *and the Equipment not meeting the requisite standards to entitle the Purchaser to claim the maximum liquidated damages* pursuant to clause 27.7.1 as set out in clause 5 above the Purchaser may give written notice to terminate the Contract immediately such failure shall be deemed a material breach incapable of remedy and pursuant to clause 34.1.2 and without prejudice to its other rights and remedies in the Contract the Purchaser may by written notice terminate the Contract immediately and take at the expense of the Contractor such steps as may in all circumstances be reasonable to ensure that the Works pass the Performance Tests."

The words deleted show that in the original draft clause 27.7.1 was concerned with delay. The words in italics are in blue and were first added by Müller in Mr Morris's email of 11 May.

75. It will be recalled that the suggestion in capital letters made by Müller was in these terms:

> "THIS SCHEDULE NEEDS TO PROVIDE THAT IF THE TEST WITHIN A CERTAIN PERCENTAGE OF THE REQUIRED LEVEL LDs WILL APPLY AND THE EQUIPMENT WILL STILL HAVE "PASSED". IF THE PERCENTAGE ACHIEVED IS

LOWER THAN THAT SPECIFIED BY LDs (I.E. LOWER THAN THE MAXIMUM PAYOUT UNDER LDS) THE EQUIPMENT WILL HAVE FAILED THE TEST AND THE OTHER REMEDIES WILL BE AVAILABLE TO THE PURCHASER"

76. It is important to note that the suggestion was not that there should be any amendment to any of the terms of clauses 7 to 48, or indeed to clause 5 or any of the other clauses. It was suggested that in some circumstances 'other remedies' should be available to Müller and, moreover, that such remedies should be provided for in Schedule 6. The problem for Müller in this regard is that it was agreed between the parties that the RTS Test Plan would form Schedules 5 and 6 and, as at 5 July, there was no further suggestion that Schedule 6 should contain something further and, if so, what that something might be. It is far from clear what Müller had in mind, but whatever it was it was not pursued.

77. As to the clauses of the contract itself, as stated above the parties agreed them as at 5 July, when the one remaining issue, which related to Force Majeure, was agreed. There was no suggestion at that time that Schedule 6 had not been finally agreed or that, because of any incompleteness in it, Müller could not or would not agree clauses 5 or 27.7. As amended in blue, clause 27.7 set out the remedies available to Müller if the Works failed to pass the Performance Tests as determined by Schedule 6. The amount payable by RTS as damages for failure to pass Performance Tests was to be that stated in clause 5, namely 2.5 per cent of the Contract Price. There is plenty of scope for argument as to the true construction of clauses 27.7 and clause 5 in the context of the RTS Test Plan which it was subsequently agreed should comprise Schedule 6. On one view the 2.5 per cent was to be both a maximum and a minimum. However, we note that clause 27.7.1 is expressed to be "without prejudice to the Purchaser's other rights and remedies". The position is further confused by the insertion, as a result of Mr Morris's emails of 11 and 16 May, of a blue 'not' in the first line of clause 27.7.2. It would not be appropriate for us to express a view as to the true construction of those terms, which (absent agreement) will be a matter for the trial judge.

78. It is Müller's concern that the effect of clauses 5 and 27.7 may be held to be that its damages for any failure by RTS to pass the Performance Tests are limited to 2.5 per cent of the Contract Price. However, Mr Maclean for Müller correctly recognised that no attempt was made to amend those clauses further. He simply relied upon the point left open by the capital letters. He submitted that in the light of that fact the court cannot conclude that clauses 27.7 and 5 were agreed terms. However, there is, in our judgment, no basis upon which the court could hold that clauses 27.7 and 5 were not agreed to be part of the agreed clauses as at 5 July. They had been agreed, in fact by 26 May (see paras 18-19 above) and, although there was initially an outstanding point in the Schedule, the terms of the Schedule

itself were subsequently agreed and, as at 5 July Müller was not saying that it could not agree either those terms or Schedule 6.

79. As is clear from his judgment, the judge focused on the position as at 5 July. He did not make any finding relating to exchanges between the parties after that and in particular on 11 or 12 July. This is not perhaps surprising because, although in his initial e-mail when sending the third draft to RTS on 11 May Mr Morris of Müller flagged the point made in the capital letters and said that he intended completing a suggested draft on this in a couple of days, he never did so or reverted to the point. Müller at no time reverted to RTS on the point before the agreed variation on 25 August or, indeed, until a much later date. Although there is some evidence that Mr Morris still had it in mind on 11 July (see the next paragraph) as long before that as 16 May he had e-mailed the fourth draft, which included the capital letters but which he referred to as the contract 'with final tweaks'. Moreover, the RTS Test Plan was agreed as Schedules 5 and 6 on 29 June. This point was not therefore presented to RTS as of any real importance. If it had been regarded as of any real importance to Müller it would surely have been referred to again before 5 July, either in the context of clauses 27.7 and 5 or in the context of Schedule 6. In these circumstances, in our judgment, whether viewed as at 5 July, 25 August or 5 September, this point could not fairly be regarded from exchanges between the parties as an essential part of the agreement.

80. We reach this conclusion having fully taken into account such evidence as there is relating to the events of 11 and 12 July. It appears that on 11 July Mr Morris gave a copy of the draft contract with its Schedules to Mr St John with a view to its being given to Mr Gavin Brown of RTS. There is evidence that a draft was given to Mr Brown and there is some evidence that Schedule 6 was in the same form as we have it in the blue version; that is with the capital letters, in other words, without any reference at all to the RTS Test Plan which had on any view by then been agreed as at least a part of Schedules 5 and 6. Mr St John's evidence was that he handed the document to Mr Brown without looking at it. There is no evidence or suggestion that it was discussed. We have been shown a copy of a document in that form which has Mr Brown's notations on it but those were put on in November, not July. The position is not clear because, when Mr Brown was asked whether that was the draft which Mr St John handed him in July he said that he could not recall his handing it to him in July. He thought he had received it at the end of October or early November, although he accepted that July was a possibility. When asked whether there had been any discussion about signing the contract in July, he said no. He then said that it had all gone quiet in mid-July and that he was expecting the schedules to be completed formally. He said that in mid-July he was content to let sleeping dogs lie and that RTS saw no problems with not signing the contract.

81. In these circumstances we conclude that there is no evidence of a discussion on the capital letters or any other point on 11 or 12 July or, indeed at any time after 5 July until much later, probably in November. Essential agreement was in our judgment reached by 5 July. None of the issues remaining after that date, including the capital letters point, was regarded by the parties as an essential matter which required agreement before a contract could be binding. On the contrary, they had agreed on the RTS Test Plan as the basis of Schedules 5 and 6. In so far as the judge reached a different conclusion in his reason ii), we respectfully disagree.

82. It is true, as the judge stated in his reason iii), that the parties did not proceed on the basis of all the agreed conditions and that not all the Schedules were agreed. The judge noted as part of his reason iii) that RTS did not procure the provision of the Advance Payment Guarantee as required by Schedule 7, provision of which was according to clause 16.1 "a condition of the contract" to be procured before any monies were paid towards the Price. That is so but that failure does not prevent the Contract having binding effect. In any event, as appears below, part of the Price was paid by Müller notwithstanding the failure to provide the guarantee. Even if (contrary to our view) procurement of the guarantee would otherwise have been a condition precedent to any contract, it was waived. The judge further noted in reason iii) that Schedules 15 and 17 were not completed, even though they address matters relevant from the start of the contract. However Schedule 15 was plainly not regarded as an essential matter: it simply related to health and safety requirements. Schedule 17 related to Site Preparations. According to an email dated 26 May sent by Mr Brown, Müller was to "provide site prep details". While it appears that Müller may not have prepared those details, the site was in fact prepared and, so far as we are aware this caused no problem. It could not be regarded as a critical provision of the contract.

83. The judge added in his reason iii) that Müller did not appoint an Engineer. However, by clause 49, the Engineer was defined as the person appointed by the Purchaser and in default of any appointment, as the Purchaser. It follows, as Mr Catchpole observed, that in default of appointment of an Engineer, Müller was the Engineer. Finally, in his reason iii) the judge said that payment was not made in accordance with the application and certification procedure laid down in clause 11, that the procedure for Changes to the Contract laid down by clause 39 was not followed and that the dispute procedure required by clause 41 was not followed. We do not see how those facts lead to the conclusion that the various clauses were not agreed as indicated above. Another point touched on in submissions was the failure of RTS to procure any parent company guarantee in accordance with clause 48A of the terms in Schedule 1. But that was a provision which was for Müller's exclusive benefit and open to Müller to waive, which in our view it clearly did by going ahead with the contract by and after the 25 August 2005 variation.

84. Although the judge did not make specific mention of the other Schedules in his reason iii), he did refer to them in his Comment box and we have dealt with them in para 21 above. In so far as some of them remained to be completed, in our judgment, they are in the same category as the terms which were not agreed in *Pagnan*. On a fair view of the negotiations and all the circumstances of the case, neither party intended agreement of those terms to be a precondition to a concluded agreement. As we say at para 23, in summary everything was agreed except for the provisions relating to the parent company guarantee and items which it was not necessary to complete or which were to be completed in the course of the project.

85. In all these circumstances we agree with Waller LJ's conclusion at para 58 of his judgment that the MF/1 conditions had to all intents and purposes been agreed and the limit of RTS' liability had been agreed. In short, by 25 August there was in our judgment unequivocal conduct on the part of both parties which leads to the conclusion that it was agreed that the project would be carried out by RTS for the agreed price on the terms agreed by 5 July as varied on 25 August.

Clause 48 and subject to contract

86. The first point remains. Had the parties agreed to be bound by the agreed terms without the necessity of a formal written contract or, put another way, had they agreed to waive that requirement and thus clause 48? We have reached the conclusion that they had. The circumstances point to the fact that there was a binding agreement and that it was not on the limited terms held by the judge. The Price had been agreed, a significant amount of work had been carried out, agreement had been reached on 5 July and the subsequent agreement to vary the Contract so that RTS agreed to provide Line 1 before Line 2 was reached without any suggestion that the variation was agreed subject to contract. The clear inference is that the parties had agreed to waive the subject to contract clause, viz clause 48. Any other conclusion makes no commercial sense. RTS could surely not have refused to perform the contract as varied pending a formal contract being signed and exchanged. Nobody suggested that it could and, of course, it did not. If one applies the standard of the reasonable, honest businessman suggested by Steyn LJ, we conclude that, whether he was an RTS man or a Müller man, he would have concluded that the parties intended that the work should be carried out for the agreed price on the agreed terms, including the terms as varied by the agreement of 25 August, without the necessity for a formal written agreement, which had been overtaken by events.

87. By contrast we do not think that the reasonable honest businessman in the position of either RTS or Müller would have concluded as at 25 August that there was no contract between them or that there was a contract on some but not all of

the terms that had been agreed on or before 5 July as varied by the agreement of 25 August. Although this is not a case quite like the *Percy Trentham* case because that was not a subject to contract case, it was equally not a case like the *British Steel* case because here all the terms which the parties treated as essential were agreed and the parties were performing the contract without a formal contract being signed or exchanged, whereas there parties were still negotiating terms which they regarded as essential. As Mr Brown said, instead of signing the contract the parties here simply let sleeping dogs lie or, as Mr Manzoni put it in his skeleton argument at first instance, neither party wanted the negotiations to get in the way of the project. The project was the only important thing. The only reasonable inference to draw is that by or on 25 August, the parties had in effect agreed to waive the 'subject to contract' provision encapsulated by clause 48. We have considered whether it would be appropriate to take a later date than 25 August, perhaps 5 September when most of RTS' equipment for Line 1 was delivered, or even 8 September when a second 30 per cent instalment of the Price was paid. However, on balance we prefer 25 August because by then the die was cast and all the parties' efforts were directed to preparations for Line 1.

88. By the time the contract was concluded, there had been some delay for reasons which were already contentious (see para 24 above and paras 53-57 of the judge's judgment). The contract, once concluded on 25 August, must, as we presently see it (though the point was not fully explored before us), be treated as applicable to the whole period of contractual performance. Any issues arising in respect of such delay would, on that basis, fall to be determined under the terms of the contract (subject to any waiver which there may have been of particular terms), as if these had already been in force during the period of such delay.

CONCLUSION

89. For the reasons we have given, we have a reached a different conclusion from both the judge and the Court of Appeal. It was agreed in the course of the argument that the court would reach its conclusions on the issues of principle before it and that the parties would subsequently have an opportunity to make submissions on the form of the order. However, subject to submissions on the precise form of order, including the precise formulation of the declarations to be made, our conclusion is that the appeal should be allowed, the order of the Court of Appeal set aside and declarations made (1) that the parties reached a binding agreement on or about 25 August on the terms agreed on or before 5 July as subsequently varied on 25 August and (2) that that binding agreement was not subject to contract or to the terms of clause 48.