‘What do you mean we don’t have a contract?’

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Abstract

When a great deal of the work under a proposed contract has carried out, Lord Denning MR emphasised in *Sykes v Fine Fare* [1967] 1 Lloyds Rep 53, that ‘the courts will do their best not to destroy the bargain’. Despite this warning forty years on, parties to construction contracts will still argue that no contract exists, even where all the work under the proposed agreement has been done.

This paper analyses a number of such cases in the light of the principles laid down by *Investors Compensation Scheme Ltd v West Bromwich BS* [1998] 1 WLR 896, and *Pagnan SpA v Feed Products Ltd* [1997] 2 Lloyds Rep 601.

What these cases do is lay down the principles that should guide a court in deciding whether agreement has been reached ‘even where [it appears]…the agreement is incomplete or insufficiently certain’.. What this analysis indicates is that it is rare for the courts to find that, in the construction context, that no contract exists. This is especially crucial in the connection with the requirement for ‘written’ contracts under the Housing Grants Construction Regeneration Act 1996 and the BERR proposals to enforce oral contracts. If this proposal does become law it will be necessary for all Construction Adjudicators to be aware of the approach of the courts and its application.

Keywords: contracts, restitution, letters of intent, essential terms, negotiation, risk

Introduction

Quite often and certainly more so with the passing of the Housing Grants Construction Regeneration Act 1996 (HGCRA 96), the question is asked: was there a contract between the parties, and if there is, what are its terms? It is a question raised frequently even with large projects, whenever a dispute arises about payment1. Even without the provisions of s 108, the question has been posed four times in the TCC between April and June 2008. In such circumstances, there are therefore two issues for a court to decide. First, do the parties indeed

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1 *VHE Construction Ltd v Sir Alfred McAlpine* [1997] CILL 1254 by HHJ Bowsher QC OR
have a contract and what happens if they do not and second, that if they did, what are the terms of that agreement and where are these terms found?

Issue one concern the requirements for forming a contract. In *Felton Construction Ltd v Liverpool CC* HHJ Toulmin CMG QC reminded the parties that the law ‘in essence [requires] three basic essentials to create of a contract: agreement, contractual intention and consideration. That the normal test for determining whether the parties have reached agreement is to ask whether an offer has been made by one party and accepted by the other’. He went on to add a reservation by observing that ‘even where an apparent agreement has been reached it may fail to give rise to a binding contract because the agreement is incomplete or insufficiently certain’.

Every student of contract law learns by heart the legal requirements for a binding agreement. This description of what makes an agreement legally enforceable appears in practice to be a fairly uncomplicated one, what then is the aim of this paper? It attempts to probe further the question originally posed in *Construction Contract Law* ‘what is so special, complex or different about construction contracts that makes their formation so difficult a problem that it often requires the help of the courts’? *Felton* presents in a nutshell, this particular problem. How is it possible to complete the building of a school and then for the contractor to claim that there was *no contract* under which the work was done? Now, the judge accepted that it was possible that an agreement may fail to become a binding contract because it is ‘incomplete or insufficiently certain’. An observation that supports the idea that though the rules for the formation of a contract seems quite clear enough, their application in practice appear to be a much more complex matter. This is especially so with construction contracts.

**Informal Contracts**

It is important to distinguish informally made contracts from those that arise out of a more ‘formal’ process. In *Clarke & Sons v ACT Construction Ltd* the Court of Appeal was faced with the familiar issue of whether there was a contract between the parties and its terms? HHJ Thornton QC decided that since the contractor had started work on an informal basis, the work was done without any contractual framework. His concluded that the work was carried out without a contract and that the contractor entitled to be paid on a *quantum meruit* basis in restitution for unjust enrichment. On appeal Ward LJ disagreed with these findings, a

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2 [2007] EWHC 3049 (TCC) para 12
4 [2002] EWCA Civ 972
conclusion shared by his fellow Lord Justices. At para 27 he stated that there were in fact three ways in which a contract might in fact arise:

- Where there is an entire contract.
- Where the parties have entered into a ‘formal contract’.
- Where there is instruction to carry out work even though no scope of work has been agreed and no price has been fixed. Provided the instruction is accepted the parties will have a contract.

Whatever the reservations of about this third approach, it provides a pragmatic solution. After all the real problem is that the work has been done and the parties are at odds over the price. The law implies into such an agreement an obligation to pay a reasonable sum for that work: a contractual *quantum meruit*. *Clarke* was such a contract. One reason the situation in *Clarke* differs from the many of the cases discussed in this paper is that the agreement was made informally. At that stage too, the parties had no idea of the amount of work that would eventually be done.

**Formal agreements**

That the carrying out of quite substantial works could cause such conceptual difficulties tends to support the idea that forming of a contract is not as uncomplicated as the basic rules suggest. Cases like *Clarke* are rare since in most cases where the issue arises such as *VHE* and *Felton*, work began initially with the issue of a letter of intent and the contractor responding by carrying out the instruction in it. Like many claims which require judicial intervention, the letter of intent was sent after a submission of a formal tender or an offer in response to an invitation to bid for work or resulted from negotiations between the parties about reductions in the price of the proposed work. In other cases it about an unacceptable risk and the price to be paid for it.

In these examples where no contract is found to exists, and work was carried out, the contractor was be entitled to claim payment on a *quantum meruit* in restitution for unjust enrichment. The court will however strive to avoid that conclusion. Thus it will, in commercial contracts, while applying the established legal principles described in *Fenton*, strive to uphold a commercial bargain entered in by the parties. This is especially so where quite often a great deal of the work under a proposed agreement has in fact been carried out. It is often at this stage that the precise nature of the dispute between the parties will need to be clarified. Lord Denning MR emphasised that forty years ago in stressing that ‘the courts will
do their best not to destroy the bargain’. Even so, it is rather surprising to find that parties are still arguing that no contract exists, even where all the work proposed has been done, and when authority is clearly against that argument.

The authorities cover two issues. One is whether out of their negotiations a contract was formed. In *Pagnan SpA v Feed Products Ltd* the Court of Appeal attempted to lay down the principles that should guide a court in deciding whether agreement has been reached ‘even where [it appears]…the agreement is incomplete or insufficiently certain’ Felton (2007) at para 12. The other is deciding what they have agreed by examining the words that they have used. What Lord Diplock in *Pioneer Shipping v BTP Toxide* described the object in construing any commercial contract. This was to ascertain: ‘what each [party] would have led the other to reasonably assume were the acts he [or she] was promising to do or refrain from doing by the words in which the promise were expressed’

**Agreements to negotiate**

Clearly then, whether or not a contract has been formed will be of great importance to the parties. Should the matter proceed to litigation, judges are then called upon to consider whether the facts match the intention of the parties. The principles of *Pagnan SpA* were applied in *Hescorp Italia Spa v Morrison Construction Ltd and Impregilo UK Ltd* where the judge applied these to determine whether a contract has been concluded. These included examining:

- The correspondence as a whole.
- Despite apparently reaching agreement, the parties may intend the agreement will be ‘subject to contract’.
- Further term or terms may have to be agreed before the contract becomes binding.
- Should they fail to do so, the agreement may still be binding if it is workable and not void for uncertainty [this is unlikely where the work has been done]
- The parties have agreed all the essential terms and what is left over are mere matters of detail.

When deciding whether a letter of intent creates a contact the important matter is whether the parties have reached agreement on the essential terms of their contract. In *Courtney &

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5 *Sykes v Fine Fare* [1967] 1 Lloyds Rep 53
6 [1997] 2 Lloyds Rep 601
7 [1982] AC 724 at 726
8 [2000] EWCA Technology 143, HHJ Hicks QC
Lord Denning observed that price in a building contract was of fundamental importance. ‘It [was] so essential a term that there is no contract unless the price is agreed or unless there is an agreed method of ascertaining it’ He went on to add that in a building contract the parties must know at the outset what the price is or what the agreed estimates are. It must be pointed out that this view might questionable after the decision in Clarke. However, there is a fundamental difference between these cases. In Clarke the work had already been done whereas in Courtney & Fairbairn the contractor was arguing that it should have been awarded the work which had been done by someone else.

A letter of intent can be construed as that creature English law does not recognise - a contract to negotiate. Lord Denning in Courtney & Fairbairn ‘I think we must apply the general principle that when there is a fundamental matter left undecided and the subject of negotiations, there is no contract.’ The case of Multiplex Constructions (UK) Ltd v Cleveland Bridge UK Ltd recently applied that principle. It was held that an express clause providing that the parties would use reasonable endeavours to agree was not enforceable.

Stocker LJ in Pagnan SpA described the expression ‘essential terms’ as an ambiguous one. One the one hand without all those terms the contract is unenforceable. On the other what is essential is what the parties agree or regard as essential is the important matter. The modern approach to essential terms is to regards the essential terms as those that will make the contract work on the ground. As a consequence what is essential may be different in different situations and is essence a factual matter. It effectively allows a judge to decide that there is a contract: unless the parties have in some way indicated that there is not. So in Bennett (Electrical) Services Ltd v Inviron Ltd where the letter of intent was headed ‘subject to contract’, the judge decided only exceptionally is such an arrangement not a condition precedent to legal liability. So despite the work having been done, he decided that all the essential terms had not been agreed. Whereas HHJ Peter Coulson QC at para 90 in Cunningham & Ors v Collett & Farmer described the essential requirements as (a) scope of work and the price (b) the contract terms (c) the start and finish dates. Beyond that what is essential as what the parties regard as essential. An instructive case is Bennett because what the judge regarded as essential terms were wider than what is usually agreed as such. The acid test seems to be ‘would the other party agree to those terms’.

The construction of contracts

9 [1975] 1 WLR 297
10 [2006] EWHC 1341 (TCC)
11 [2007] EWHC 49 (QB)
12 [2006] EWHC 1771 (TCC)
In deciding what the agreement is, courts have to construe the words used in the course of negotiation. The process is called construing the contract. In construing a contract the court applies the rule of law that while it seeks to give effect to the intentions of the parties it must give effect to the actual words used. It must decide what the parties actually meant by using those words. This is described by the phrase the ‘expressed intention’ of the parties. Lord Hoffman in *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* 13 reiterated the well-known principle that the law was not concerned with the subjective intention of the speaker. He went on to comment that contained in the expression, ‘the meaning of the words’, was an ambiguity that could not be ignored. This ambiguity was itself twofold. One concerned the meaning of the actual words themselves, whether contained in dictionaries or in the effect of their syntactical arrangement in grammar. The second was what the person who used them understood them to mean with regard to the factual background in which they were used. He went on to say: Increasingly the courts have used the factual background as a means of deciding what the intentions of the parties were.

In *Investors Compensation Scheme Ltd v West Bromwich BS* 14 Lord Hoffman provided a summary of the principles involved. First, the document is interpreted against the background knowledge available to a reasonable person at the time of contracting. That background includes the ‘matrix of fact’. This includes how a reasonable person would understand the document in the context of that matrix of facts. What is excluded from consideration is evidence of previous negotiations or agreement. A distinction is made between (a) the meaning that a document would convey to a reasonable man or woman and (b) the meaning of the words. This is function of dictionaries and grammar. Whereas the meaning of documents is what those parties meant by the words they used against the factual background in which they were made. It enables the reasonable person to choose between the possible meanings of the words which are ambiguous and even to conclude that the parties must, for whatever reason, have used the wrong words or syntax. The rule that words must be given their ‘natural and ordinary meaning’ too reflects the proposition that linguistic mistakes in formal documents are difficult to accept. This must be construed against the factual background that where ‘detailed semantic and syntactical analyses of words in commercial contracts is going to lead to a conclusion that flouts business common sense, it must be made to yield to business common sense’ : Lord Diplock in *Antaios Compania Naviera SA v Salem Rederierna AB* 15.

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13 [1997] AC 749
14 [1998] 1 WLR 912
15 [1985] AC 191 at 201
For the application of these principles in a construction setting

HHJ Seymour QC in *Tesco Stores Ltd v Costain Construction Ltd* applied these principles. The claimant alleged that the contractor was in breach of the contract by which it agreed to design and construct a superstore, and negligent, in relation to failing to provide adequate fire stopping and inhibiting measures in the constructed store. Had they done so adequately the fire would have caused far less damage than it actually did. The claim was for the additional costs it suffered as a result of lack of adequate measures to retard the spread of the fire. The contractor denied that it had concluded any contract with claimant in relation to the construction of the store but admitted that it had in fact built it. The parties having never entered into a formal agreement work once work started with the issue of a letter of intent. The judge was faced with the complex task of working out what the parties had agreed.

He concluded that the parties did make a contract in 1989 under which the defendant undertook to carry out work of constructing the store. The contract was made by the counter-signature on behalf of the defendant and returning to the claimant their letter dated 20 March 1989. [In fact the letter contained all the essential terms]. He decided that the only document incorporated into the contract was the letter as counter-signed and returned. The express terms of the contract were only that the defendant would start the construction of the store in advance of the making of a formal contract. Terms to be implied into the contract were that the construction work would be carried out in a good and workmanlike manner and that any design element carried out by the defendant would be reasonably fit for its intended purpose. In effect he concluded that there was a contract and in the process applied the principles in *Pagnan Spa* and *Investors Compensation Scheme* to do so.

Recent cases

In *Haden Young Ltd v Laing O'Rourke Midlands Ltd* once again work started with a letter of intent and continued to practical completion without agreement being reached on the terms of the sub-contract. The mechanical and electrical sub-contractor claimed there was in fact, no contract. The judge agreed and held that they were entitled to payment on the basis of a quantum meruit for work done. What is also clear is that throughout the parties were in dispute about certain essential terms. The sub-contractor sought a limit on indemnity

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16 [2003] EWHC 1487 (TCC) this is a multi-faceted case that repays the time spent on it.
insurance cover of £5m, wanted to limit the number of assignments of a collateral warranty from two to one and sought the removal of the provision linking payment with the provision of the warranty. No contract was thus made because the parties were unable to agree the essential terms. This was an example of unacceptable risks preventing the forming of a contract.

By contrast in *RTS Flexible Systems Ltd v Molkerei Alois Müller GmbH & Co Kg (UK Productions)* 18 the parties entered into negotiations for the design, manufacture, supply, installation and testing of equipment. Work started on a letter of intent and resulted in the familiar refrain of whether there was a contract and what were the terms. When the letter of intent expired the suppliers continued building the equipment and were partially paid for the work. Applying *Trentham v Archital Luxfer* 19 the judge decided that even though the classical analyses of offer and acceptance were missing a contract arose by performance. He also found that the parties in doing so had not agreed any terms and conditions and proceeded on the same terms as contained in the letter of intent.

*Diamond Build Ltd v Clapham Park Homes Ltd* [2008] EWHC 1439 (TCC) (25 June 2008)

Mr Justice Aikenhead described the issues between the parties as being whether the Letter of Intent had been superseded by a contract incorporating the JCT Intermediate Form of Building Contract, 2005 edition. He considered that once the Letter of Intent was in effect accepted by being signed and returned as requested the only essential matter left to be done was the execution of a ‘formal’ contract. Under the letter of intent the contractor was required to take possession within 28 days. He concluded that the parties had known by about 6th or 7th June 2007 that all material terms of their contract were in fact agreed. The only purpose of the letter then was to cover the period between the issue of the Letter of Intent and the execution of the formal contract. This would explain the fact that the penultimate paragraph of the letter ‘construed properly, means that the undertakings given in the letter (including

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17 [2008] EWHC 1016 (TCC) (08 May 2008)
critically the obligation to reimburse reasonable costs (albeit up to a cap) in the fourth paragraph) were to continue until the formal contract was executed’. Therefore the parties would have been aware that Preliminaries required a contract under seal. As Lloyd LJ said in Pagnan SpA ‘the parties are masters of their contractual fate’. In accepting the letter of intent the parties had agreed that it should dictate their rights and obligations until a formal contract was signed.

Cubitt Building & Interiors Ltd v Richardson Roofing (Industrial) Ltd\(^\text{20}\) there was a quotation which was followed by a letter of intent being issued. The letter required an acceptance of the letter by returning it with a signature but this was never done. A disagreement arose as whether the contractor’s standard terms applied or the DOM/1 standard form of contract governed the sub-contract. In the contractor’s standard form an application for an extension of time had conditions precedent whereas the DOM/1 has none. As a matter of construction the judge decided that the DOM/1 governed the sub-contract. As to whether there was a contract and what was the result of the battle of the forms, the judge also interpreted the letter of intent as offer which the sub-contractor accepted by starting work.

**Section 107 of the HGCRA 96**

The application of the provisions of the Act depends on whether it is compliant with the section. The meaning of the phrase ‘a contract in writing’ was considered in RJT Consulting Engineers Ltd v DM Engineering (Northern Ireland) Ltd\(^\text{21}\). By a majority the Court of Appeal decided that all the material terms of the contract had to be in writing. Since that decision there has been a great deal of litigation caused by the widespread use of letters of intent to initiate projects. This has resulted in abortive adjudication proceeding as the courts decided that the adjudicator had no jurisdiction as the agreement failed to comply with s 107.

The case of Tally Wiejl (UK) Ltd v Pegram Shopfitters Ltd\(^\text{22}\) demonstrates the difficulty caused. The Court of Appeal concluded that there was no contract between the parties. It

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\(^{19}\) [1993] 1 Lloyds LR 25 in this case the court of appeal decided that where was completed and paid for, it was unlikely that no contract existed.


\(^{21}\) (2002) 18 Const LJ 425 CA

\(^{22}\) [2003] EWCA Civ 1750
decided that the judge, in deciding to enforce the adjudicator’s award, was wrong, (as was the parties and the adjudicator) in assuming a valid construction contract existed under the HGCRA 96. What must be appreciated is that in embarking on adjudication, high court proceedings to enforce the award and an appeal against that decision, the parties still ended up without a solution to their quarrel.

_Harris Calnan Construction Co Ltd v Ridgewood (Kensington) Ltd_ 23 demonstrates the approach of the courts since _Tally Wiejl_. A claim was made for £102,274 arising out of an adjudicator’s decision. The defendant claimed that there was no contract in writing. The matter was raised in the adjudication and the adjudicator considered the submissions made by the parties. He decided that there was a contract in writing and the challenge to his jurisdiction failed.

Where a party has a jurisdiction challenge in adjudication there is a clear choice. It can either agree that the adjudicator should decide the question of jurisdiction and to be bound by the decision. It may also as an alternative reserve the right to argue that whatever decision the adjudicator makes, the adjudicator did not have jurisdictions to decide the matter.

In this case the letter of intent made plain that there (a) a contract workscope (because it was contained in what was described as ‘Tender Documents dated 2nd November, 2005’) (b) an agreed lump sum of £200,787.75 (c) agreed set of contract terms (namely the JCT 2005 Standard Form, Private with Quantities) (d) a 5% retention rate (e) liquidated damages of £5,000 per week and (f) a contract period of sixteen working weeks. As clearly all the essential terms were agreed the adjudicator decided that there was a binding contract. The judge agreed there was one and that it was made in writing. As the defendant had not reserved its right to argue that the adjudicator had no jurisdiction to decide that, he enforced the award.

_Hatmet Ltd v Herbert (t/a LMS Lift Consultants)_ 24 the defendant’s case was that the contract was made orally and therefore the adjudicator had no jurisdiction. The claimant's case is that a contract was made by exchange of communications in writing, as section 107.2(b). A sketch of indicating the scope of work and the defendant’s order was held to be sufficient to amount to as contract by an exchange of communications

**Proposals for change**

23 [2007] EWHC 2738 (TCC) (15 November 2007)
The Community Empowerment, Housing and Economic Regeneration Bill will implement the BERR proposals\textsuperscript{25} that oral contracts and partly oral contracts should be subject to adjudication. The Bill is expected to be implemented in the next session of Parliament\textsuperscript{26}. The aim of the Legislation is to amend the HGCRA 96 and to improve the operation of construction contracts by improving Cash flow through Construction supply chains and to encouraging parties to resolve disputes by adjudication rather than by litigation. One way of doing this is widen the agreements subject to the Act.

\textbf{Conclusion}

Whether or not a contract has been formed is of course, of great importance to the parties, who will have spent time and money on trying to reach agreement. Sometimes at the end of process they may be unsure of the state of their negotiations. Judges are then called upon to consider whether the facts and the intention of the parties are compatible. Usually to break the dead log of negotiations one party will issue a letter of intent. Now such a letter tries to do two contrary things (a) persuade the contractor to start work and (b) limit the cost payable if agreement is not reached. Therefore it is primarily with the allocation of risk that the parties are concerned. In \textit{Fenton}, the parties by negotiation sought to reduce the tender price. At the end of the contract they were far apart as to what the final value of the work was. The contractor was thus easily persuaded by the argument that there was no contract to carry out the work. It could therefore argue that without a contract it could make a claim based on the value of the actual work carried out for restitution for unjust enrichment.

Authority though was against the contractor. The principles in \textit{Pagnan SpA}, \textit{Mannai} and \textit{Investors Compensation Scheme} enable a judge to find a contract and its terms. This it will do especially when the work has been done. Unless the parties specifically make the agreement subject to contract, the court will find a contract has been made.

It is clear that when the letter of intent is examined the court will first search for the essential terms. Signing and returning the latter is construed as an acceptance. Sometimes not returning and signing the letter will make no difference, if all the essential terms are agreed. In the context of s108 of the HGCRA 96, the courts it seems likely will construe the letter as a contract in writing if it contains all the essential terms.

What this analysis indicates is that it is rare for the courts to find that in the construction contracts that no contract exists. This is especially crucial in the context of the requirement for ‘written’ contracts under the Housing Grants Construction Regeneration Act 1996 and the BERR proposals to enforce oral contracts. If this proposal does become law it will be necessary for construction adjudicators to understand the process by which the courts reach this decision and apply it in the short space of time that the legislation provides. It is also clear that the industry’s failure to make formal contracts is also a matter of risk allocation. In the short time frame in which agreements are made for works of construction, doing the work takes priority over agreeing the risk allocation. So the warning for contract parties is that where the work is done, the courts are likely to find there is a contract, despite what the legal advice says.