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**Intention to Create Legal Relations and the Application of RTS Flexible Systems Ltd:
Barbudev v Eurocom Cable Management Bulgaria [2012] 2 All E.R. (Comm) 963**

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Legal framework

The leading case on whether parties intend to create legal relations is *RTS Flexible Systems Ltd v Molkerei Alois Müller GmbH & Co KG* [2010] 2 All E.R. (Comm) 97. As if to emphasise the capriciousness of contract law, the Supreme Court reached a decision which differed from both the judge at first instance and the Court of Appeal on whether the parties had reached an agreement and which, per Lord Clarke, demonstrated “the perils of beginning work without agreeing the precise basis upon which it is to be done”. Although the decision depended on its particular facts, Lord Clarke set out the general principles at [45] which he said, without any apparent irony, were 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.”

At issue was whether, objectively appraised, the parties’ intention had been that the detailed terms negotiated by them would not have contractual effect until the relevant documentation had been formally executed and signed, the work had been performed and the price paid.

The Supreme Court referred to a matrix of cases in which this issue had been considered: *British Steel Corporation v Cleveland Bridge and Engineering Co Ltd* [1984] 1 All E.R. 504; *Pagnan SPA v Feed Products Ltd* [1987] 2 Lloyd’s Rep. 601; and *G Percy Trentham Ltd v Archital Luxfer Ltd* [1993] 1 Lloyd’s Rep. 25. In *British Steel*, Robert Goff J. had found that the parties had not reached agreement, even though the work had been carried out, so that payment was based on restitution. He said at 510g–510h that

“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”.

By contrast, in *G Percy Trentham*, Steyn L.J. noted that a distinctive feature of the case was that the agreed work had been done and the agreed payment made, even though the defenders disputed the formation of binding subcontracts. In a case where the transaction was fully formed he said that it was

implausible to argue that there was no evidence of an agreement since a contract could be concluded by conduct,

“in this fully executed transaction a contract came into existence during performance even if it cannot be precisely analysed in terms of offer and acceptance” (at 29).

In *Pagnan* the court held that the parties must have made a sufficiently complete and certain agreement on all essential terms for an agreement to be enforceable. At 619, Lloyd L.J. emphasised that where parties intended to be bound even though further terms were to be agreed, a failure to agree those further terms would only invalidate the contract if it became unworkable or void for uncertainty and that the parties were the masters of their contractual fate.

In *RTS Flexible Systems Ltd* it was argued that there was a conflict between these cases. Lord Clarke disagreed: at [54] he said that each case depended on its own facts. There was no presumption that performance inferred a concluded contract, even though it was plainly a relevant factor. In *British Steel* Robert Goff J. had been influenced by the issue of liability for defects which had been contested by the “battle of the forms”. Lord Clarke’s view emphasises the limited precedent value of cases in which the courts have considered the issue of contract formation.

Merely establishing an intention to create legal relations will not get a party very far since it is also essential to prove an agreement. An agreement to agree or to negotiate, whether or not supplemented by a requirement to do so “in good faith”, is legally unenforceable (*Walford v Miles* [1992] 2 A.C. 128), certainly in English law. As per Longmore L.J. in *Petromec Inc v Petroleo Brasileiro SA* [2005] EWCA Civ 891 at [116]:

“The traditional objections to enforcing an obligation to negotiate in good faith are (1) that the obligation is an agreement to agree and thus too uncertain to enforce, (2) that it is difficult, if not impossible, to say whether, if negotiations are brought to an end, the termination is brought about in good or in bad faith, and (3) that, since it can never be known whether good faith negotiations would have produced an agreement at all or what the terms of any agreement would have been if it would have been reached, it is impossible to assess any loss caused by breach of the obligation.”

If the document is a “letter of comfort”, it will not usually give rise to legal obligations (Maurice Kay L.J. in *Associated British Ports v Ferryways NV* [2009] EWCA Civ 189; [2009] 1 Lloyd’s Rep. 595 at [27]).

The background in *Barbudev*

The claimant, B, had built up a cable television and internet business, Eurocom Plovdiv (named after Bulgaria’s second city), into the second largest in Bulgaria. In 2004 he and the defendants were negotiating a share purchase agreement (“SPA”) since the defendants, members of a private equity firm, had already bought one Bulgarian cable business and were looking to merge the claimant’s business into their own. B’s case was that the parties had orally agreed at an earlier meeting that he would be a 10 per cent shareholder in the new merged business, agreement of which was then reflected in a side letter from the defendants to B which contained the following provision:

“In consideration for you agreeing to enter into the [SPA], the purchaser hereby agree that, as soon as reasonably practicable after the signing of the [SPA] by all parties, we shall offer you the opportunity to invest in the [merged company] on the terms to be agreed between us which shall be set out in the investment agreement and we agree to negotiate the investment agreement in good faith with you.”

The side letter also specified the price to be paid by B for the 10 per cent shareholding. The SPA was executed and the shares purchased but, although the defendants provided B with a draft investment agreement, the negotiations broke down. The shares in the merged business were sold and B raised an action for breach of the agreement contained in the side letter for him to acquire the 10 per cent shareholding. The defendants' position was that there was only an agreement to agree, which was unenforceable. B sought damages based on the profit which the defendants had made on 10 per cent of the shares sold. However, as the trial was on liability only the issue of damages did not arise.

First instance judgment

Blair J. ([2011] 2 All E.R. (Comm) 951) noted that what had given rise to the litigation was a perception on B's part that he'd been tricked out of a share in the resale of the business which he founded, and a perception on the defendants' part that his claim was purely opportunistic. He said at [89]–[90] that the three issues (intention to create legal relations, a binding contract or mere agreement to agree, and sufficiently complete and certain agreement on all essential terms), although in principle distinct questions, were "hard to disentangle from each other". The issue commonly arose in different guises in commercial transactions:

"Parties may reach a binding agreement as to essentials, on the basis that other terms are to be agreed later. Or a letter of intent, however described, may simply mark a point in their negotiations or, as in the case of a letter of comfort, be provided on the understanding that it is not to be legally binding. Sometimes the issue turns on a single document, sometimes on a series of documents. The agreement may have been acted upon, or it may remain unperformed. Within certain established principles, English law adapts a pragmatic approach to such issues. The parties are to be regarded, [per Bingham J. in *Pagnan SpA v Feed Products Ltd* [1987] 2 Lloyd's Rep. 601 at 611], 'as masters of their contractual fate'".

He rejected B's claim that he had orally agreed his 10 per cent share with one of the defendants' directors and said that an agreement, if it existed, was found only in the side letter. He agreed with the defendants that the parties had not intended to create legal relations because the letter itself was not intended to be legally binding; he also agreed with the defendants that the side letter was not a legally binding contract but an unenforceable agreement to agree because, on a proper construction, the agreement between the parties was that B was to have the opportunity to invest on terms to be agreed which would be set out in an investment and shareholders' agreement which the defendants agreed to negotiate with the claimant in good faith, notwithstanding the apparent agreement on the size of the shareholding and the price to be paid. He also found that the letter was not a complete and enforceable agreement because essential terms for an investment agreement, such as when and how B could be bought out or get out of his investment, had not been dealt with in the letter.

The Court of Appeal

The only aspect of Blair J.'s decision with which the Court of Appeal disagreed was the first finding since the terms of the side letter made it clear that the parties had intended to create legal relations (Aikens L.J. at [37]). The fact that the letter was not a binding agreement implies that establishing legal relations is a rather unnecessary exercise.

Conclusion

The moral of this case is, unsurprisingly, to obtain agreement on the terms of an investment agreement rather than relying on the comfort of a side letter; more generally, that predicting the

outcome of a trial on whether parties have reached a binding agreement is extremely difficult and that litigators should not be afraid of advising their clients accordingly.