**The Spot market and chaotic contract formation – a few reflections on a challenge to modern legal systems**

*Is classic contract theory compatible with modern methods of contract making? In many markets for commodities, shipping and - perhaps ironically - insurance, contract formation takes place at a great distance, between parties who have not previously met or done business and who are in a hurry to fix the deal, while happy to dispense with lawyers and detailed consideration of agreements. Contract making also takes place by an extended process of offers, counter-offers, exchanges of standard terms and more or less vaguely worded acceptances. Notoriously, the common law does not include subsequent conduct among the facts indicating whether a contract was in fact concluded – it is only indicative of whether that party thought a contract had been concluded. How can one party therefore be sure that a contract has been put in place and how is it to dare act in reliance thereupon, perhaps incurring expenses and liabilities in so doing?*

Any first-year student of any legal system in the world is taught that there are two essential elements required for a contract to come into being: offer and acceptance. Some are taught that consideration is also needed.[[1]](#footnote-1) Others, in some civil law jurisdictions are taught that *causa* is required.[[2]](#footnote-2) Consideration and *causa* are additional concepts that may or may not be recognised and considered essential by the law – but offer and acceptance are not optional – they must be in place and if there is a mis-match between offer and acceptance, the next communication is not an acceptance but a ‘counter-offer’ replacing the original offer as the starting point for contract-formation.

The spot market, boosted by modern electronic means of communication and contract formation, represents a practical challenge to this simple and elegant, but in the modern world occasionally quite fictional model of contract formation. Contracts in the spot market are made constantly in large numbers every day. There are several industries that may be considered to trade in spot markets, including commodities trades and charterparties. These trades represent values of billions of dollars and if we were to create contract law from scratch today, their sheer value might even mean that we would use such contracts as a model rather than the first year law student’s construct. The latter is arguably an excessively simple model better adapted to the sale of a horse or a piece of farming equipment. In the spot market, the contracting parties typically do not know each other or anything about each other, they have not done business before, they are negotiating very quickly with time at a premium and negotiations are conducted not in person, but over email. In a complex exchange of partial written communications, a term may have been mentioned once but not again thereafter, leading one party to think that there was agreement, and the other party to think that the term was not insisted upon. Indeed, the parties to the type of contract at issue are fairly likely to purposely neglect to mention a contract term that they anticipate may be difficult to negotiate, in the hope that the contingency where that contract term needs to be applied will not arise. Because of the criss-crossing of communications between the parties and the need to preserve an agreed position on the price, there is a need to acknowledge receipt of communications and send holding responses to permit consideration of the other party’s offer. Such confirmations of receipt and holding communications need to be perfectly clear as to their content, or the receiving party will be entitled to interpret them as an acceptance of the offer made, and a mutual agreement entered into. Needless to say, the parties will not always succeed in staying on the right side of the line between confirmation of receipt and acceptance. The use of brokers may confuse matters further in altering the meaning of communications and in creating delays between one communication and the next.

The absurdity of this method of negotiation becomes most evident when we consider English law on contract formation. The parties will have made a contract when there is agreement on all essential terms, even if some terms are left for later negotiation.

It is typically the case that main contract terms are agreed and much of the contract is left for later determination between the parties (not as with Lloyd’s Open Form salvage by an arbitrator, but by the parties themselves). Unless something goes wrong with the sale, there is typically no need to agree or even discuss the further and more detailed particulars, some of which would in the context of a different type of contract be considered utterly essential.

**Importance of the issue**

This is an issue that must be resolved by all legal systems, because it is ultimately the binary question of the existence of a contract between two parties. The rights and liabilities of a large number of parties to such contracts are at stake and every legal system is in need of being in a position to answer the question of whether a contract has been put in place or not. Ultimately trade, shipping and insurance all rely on receiving an answer to this question that they can live and work with.

In many civil law systems there is the concept of *culpa in contrahendo*. The negotiating parties are under a duty to behave carefully in negotiating and may become liable for losses incurred by the other party. This concept is present in German law and Scandinavian law and represents a shade of grey or a half-way house in response to the pure, binary question. The author is informed that the Chinese Contracts Act 1999 section 42 stipulates damages in case a negotiating party causes loss to the other party by pretending to conclude a contract, and negotiating in bad faith; or by deliberately concealing important facts relating to the conclusion of the contract or providing false information; or by performing other acts in violation of the principle of good faith. In addition, section 43 prescribes that disclosing trade secrets will give rise to liability whether a contract is ultimately established or not. These provisions operate at the pre-contractual stage and fulfil the purpose of mitigating the effect of a radical finding that there is or is not a contract, in circumstances where one party has acted inappropriately causing the other party to incur expenses or liabilities (to put it in non-legal terms).

However, the concept of *culpa in contrahendo* and related concepts are not suitable for use in the spot markets where negotiations are almost instantaneous. It has a more natural home in construction contracts or other contracts that evolve over time and are renewed, altered and confirmed as work progresses.

**Contract making**

If therefore *culpa in contrahendo* and similar instruments are not a workable way to mitigate errors arising from fault contract making processes, we are left with a truly binary contract-making procedure. We must look, in circumstances where it is the nature that none will be found, for an offer and an acceptance. The rest of this presentation reviews some recent instances of cases where contracts were said by one party to have been made, and by the other not to have been made. It is suitable to start with the relatively recent Supreme Court Authority from *RTS Molkerei v Alois Muller*. [[3]](#footnote-3)

BY way of background, an offer may be unsuitable as a basis for a contract because it is ambiguous or incomplete. If the offer is incomplete, there are various ways in which the law may fill it out, for instance using implied terms or stipulating that some terms are essential so that a contract cannot be made without them. This already is a form of certainty permitting the parties – and the courts to say with certainty that a contract was, or was not at hand. However if the offer is ambiguous, the burden on the courts is heavier as they must then infer a contract from the parties’ intentions and a variable set of circumstances. While the traditional stance is to require clarity and specificity so that it is clear what intentions the parties had and how to give effect to them, there is today “an established reluctance to strike down what were obviously intended to be legally enforceable commercial agreements”.[[4]](#footnote-4) In other words, if the parties have obvious commercial intentions and have negotiated an agreement which later proves ambiguous and difficult to enforce, the courts will not nullify the entire bargain on a technicality or because in hindsight the drafting proves not to be up to the challenge.

In *RTS Flexible Systems Ltd v Molkerei Alois Muller GmbH & Co KG,* the parties had entered into negotiations to supply and install automated packaging machinery for the defendant, a producer of dairy products. The parties had agreed a letter of intent so that they could begin works, but the letter of intent expired and no further formal contract was made, although the parties carried on with the work. All negotiations were said to be subject to contract.

Although the Supreme Court laconically noted that “The moral of the story to is to agree first and to start work later”,[[5]](#footnote-5) it upheld the bargain of the parties, such as it was. The Supreme Court held that although the parties had negotiated contract terms "subject to contract" but work had begun before the terms were finalised, there was a contract on the terms that had been agreed.

The case is by no means the first to address the issue. Restricting the background to cases where modern means of communication were used, *Pagnan SpA v Feed Products Ltd*[[6]](#footnote-6) was a case where a contract for the sale of a quantity of corn feed pellets was said to have been concluded by telex. Having exchanged several telexes, the sellers arrived no less than twice at the belief that the only points of difference had been agreed. Mr Justice Bingham at first instance as well as the Court of Appeal concluded that contract had been concluded on the first pleaded occasion, at a stage when the parties had (in the words of the judge) mutually intended to bind themselves on the terms agreed on Feb. 1, leaving certain subsidiary and legally inessential terms to be settled later.[[7]](#footnote-7)

The Court of Appeal 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 had continued negotiating even after the contract had been made, because they had made an interim agreement that required further terms to be agreed.

In some cases therefore a partially agreed contract will be upheld by the courts, in other cases it will be insufficiently precise to be enforceable. In *Pagnan*, Lord Justice Lloyd summarised the relevant principles, and it is worth reproducing these here in full.

“(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 right away** 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 p 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’.” [[8]](#footnote-8)

It should be noted that while *Pagnan* concerned a speedily concluded sale contract, *RTS* concerned a long term business relationship carried out in stages. The conclusions from the latter may be less apposite to a spot sale for that reason.

In *RTS*, the Supreme Court considered that it was not really an option to hold, as the Court of Appeal had done, that the parties had not concluded any contract at all. This was principally because in the letter of intent, the parties had agreed the entire contract sum and not just the contract sum. Although at that stage the agreement was expressly stated to be subject to contract, the Supreme Court held that it was not an option to hold that no contract at all had been concluded – there had obviously been agreement on the price, and the question was just the extent of that agreement. The Supreme Court also found that the term “subject to contract” had been waived – it did not consider that the waiver had to be express, but held that by a certain date, that term had been waived so that a contract had come into existence. That being the case, there followed much debate about what set of contract terms had been incorporated and represented the content of the contract.

Following *RTS*, it is clear that the requirement for certainty as to terms and conditions and as to essential terms is not the sharp requirement it once was.

**Recent English case law**

Two recent English cases provide interesting facts challenging the classic contract formation model. are helpful as models in determining whether or not a spot market contract has come into being, namely *Glencore Energy Uk Ltd v Cirrus Oil Services Ltd[[9]](#footnote-9)* and *Proton Energy Group SA v Orlen Lietuva*.[[10]](#footnote-10)

In *Glencore*, the claimant sought damages from the defendant, Cirrus Oil, for repudiation of a contract alleged to have been made on 4 April 2012 for the sale of 630,000 barrels (plus or minus 5 per cent at Glencore's option) of Ebok crude oil.[[11]](#footnote-11) Glencore's case was that the contract was concluded when a "firm offer" made in an email of 3 April 2012 was accepted by a "good news" email from Cirrus Oil on the morning of 4 April 2012. The parties were negotiating via email and there was a clearly determined purchase price. The following questions arose.

(i) Was there a concluded contract between Glencore and Cirrus Oil on 3 and 4 April 2012 or were the arrangements then made "subject to contract" or to finalisation of further terms?

(ii) What was the identity of the buyer? If no buyer was identified, was there no contract?[[12]](#footnote-12)

The judge gave damages to Glencore with reasoning as follows.

(i) Was there a concluded contract between Glencore and Cirrus Oil on 3 and 4 April 2012 or were the arrangements then made "subject to contract" or to finalisation of further terms?

(1) It was clear that the parties intended to conclude a binding contract before the extended deadline of 11.00 on 4 April. There was no room for any suggestion that the deal remained "subject to contract". The "firm offer" email was intended to be capable of acceptance with a binding contract thereby concluded, with a deadline for acceptance. The email set out all the main terms necessary for a contract to be concluded and also general terms and conditions which were to be the 2007 BP General Terms and Conditions for cfr sales. The "good news" email was a clear acceptance of the "firm offer" and could only mean that there was acceptance of the main terms set out in the firm offer with intention to revert on fine tuning of contract terms.

(2) The intention to "revert on the fine tuning of the contract terms so that it was back-to-back" was not making the acceptance subject to such agreement but giving notice of the likelihood of a wish to negotiate about the detailed terms to be found in the BP General Terms and Conditions. There could be no going back on the main terms which, in a spot contract of this kind, were clearly and sufficiently set out and agreed.

The judge in this case did not emphasise the fact that the purchase price had been agreed, like the Supreme Court did in RTS, so that there must be a contract in place. This makes sense, as the purchase price in RTS was agreed at the outset but for the entirety of the contract works. Here, the purchase price was for the specified amount of commodity only – it was a classic spot sale. Although the Supreme Court in *RTS* emphasised the purchase price, it is not possible to say that once the price has been agreed, the court is more likely to find that there was a contract in place. It has to be said, in a spot sale it would often make a lot of sense to take agreement upon the price as agreement as to the whole. Other terms may vary, but the price is the paramount term to a spot sale.

Instead, in *Glencore*, the determining factor was that the parties had used the language of “firm offer” and “good news”. This leads us to the other recent case, namely *Proton v Orlen Lietuva*.

In *Proton*, the parties were again negotiating the sale of oil via email. By an email sent on 14 June 2012 Proton made what was described as a "firm offer" to sell to Orlen cif Butinge, Lithuania 25,000 mt +/- 10 per cent in the seller's option of Crude Oil Mix CN27090090, European origin, with delivery period at the discharge port during 10 to 15 July 2012 and at a price based on five quotations after the bill of lading date.

Email correspondence continued between the parties on the same day, culminating in a one-word email from Orlen stating: "Confirmed". On 20 June 2012 Proton sent Orlen a draft detailed written contract for the sale. The draft terms of this written contract provoked further email exchanges and ultimately a revised draft which Proton sent to Orlen on 27 June 2012.

At this stage, there was at least one issue on which the parties had not agreed: namely, the documents which Proton would be required to present for payment under a proposed documentary letter of credit. On 29 June 2012 Orlen wrote to Proton to say that it was withdrawing from the negotiations. It did not open any letter of credit and it did not accept the cargo. On 2 July 2012 Proton notified Orlen that it was accepting Orlen's failures to open a letter of credit or to take delivery of the cargo as repudiatory breaches of contract and was thereby bringing the sale contract to an end.

One of the issues discussed in the case was the various market practices in the oil trade. Orlen Lietuva had argued that in trades where both parties were spot traders and the priority was on locking in the price of the commodity, a recap with a firm offer would be considered binding. In such trades, the parties were not contemplating physical delivery because the commodity was going to be sold again before delivery in any case. On the other hand, in a trade where one of the parties was a refinery, it was more important to determine further the details as to quality, quantity and delivery, and the price was not as important a term. Based on such differences, Orlen Lietuva successfully asked the judge not to award summary judgment to Proton, so that it could bring evidence as to whether a contract had been made according to the practice in the trade.

In a judgment on 24 September 2013, HHJ Mackie QC held that Proton’s claim succeeded - the parties had entered into a binding agreement. A contract had come into existence between the parties and had been repudiated by Orlen, which was liable in damages.

(1) The evidence pointed to there being a single contract formation mechanism in the oil trading market, and not a segmented market where contract formation depended on the nature and identity of the parties.

(2) A contract had come into existence on 14 June. On that date, not all terms had been agreed, and the dealings did not neatly fit the conventions of English contract law, but the overall picture was clear and the language was that of commitment. Both parties had seen themselves as committed at the time.

**Spot trading and contract making**

Guidance in this type of case must always ultimately be derived from Lord Clarke’s speech in the Supreme Court’s judgment in *RTS Flexible Systems Ltd v Molkerei Alois Müller GmbH & Co KG* [2010] 1 WLR 753, by which the parties are held to the following standard.

“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.”

In the absence of a clear-cut offer and acceptance, the successful claimant’s argument and the reasoning of the judge focused on the language employed by the parties. Both parties understood that not all contractual terms had been agreed. This was not fatal since under English law a contract will be binding upon the parties as long as they intended to enter into contractual relations and agreed on the essential terms.[[13]](#footnote-13)

As pointed out by counsel for the claimant, its offer was said to be a “firm offer”. This was “language requesting a binding commitment – a definite acceptance or rejection – in reply”.[[14]](#footnote-14) The offer was said to be “valid till 14.06.2012 COB”. As the judge put it, “This ‘*firm’*, time-limited offer ‘*did not admit of languid negotiation*’. It demanded an immediate, binding commitment. In addition, the transaction contemplated was spot business and of an immediate nature. The offer also explicitly contemplated that further contractual terms should be negotiated.

Two factors appear to have been decisive to the judge’s conclusion. First, these were events taking place in the spot market which moves fast and where deals are concluded with details to be determined at a later (but not much later) stage. The defendant’s argument in the decision on summary judgment was that whether a contract had been concluded depended on the identity and nature of the parties, so that retail and wholesale traders would be treated differently. This was not ultimately accepted by the judge who emphasised the spot nature of the trading market – presumably an unspoken idea here was that one may or may not have the full picture of who the contracting party is in such a market. In some businesses, the nature and identity of the contractual party is essential but in the spot market, it could not matter less – what matters is to sell the cargo by its best before date and agree payment by a secure method, and conversely to secure cargo of contractual quality and quantity. It would be unreasonable to expect parties operating in such a fast-paced environment to set out all the terms of the agreement between them in a written contract. It makes much more commercial sense to allow them more flexibility in conducting their business.

**The language of commitment**

The second factor was language. The judge noted, succinctly, that “the language is that of commitment”.[[15]](#footnote-15) He noted that the parties to a spot deal in a hectic market situation, coming from a spectrum of cultural, commercial, legal and linguistic backgrounds cannot be expected to “conduct all aspects of their dealings to fit the conventions of English contract law”. However, the parties could, and should be expected to correctly utilise the language of commitment. A “firm offer” meeting with the response “confirmed” looks and smells like a contract and it is only right that it should in fact be a contract. This description, “the language of commitment” is a useful one to describe what must ultimately always be a subjective definition of objectively ascertainable events.

It is worth noting the very subtle deviation from the standard established in *RTS Flexible Systems* above, which refers to both “words and conduct”. In the case of a trade where the language of commitment is the crucial beacon to look out for, the opportunity for the influence of the conduct of the parties may be diminished. This leads neatly on to the point of subsequent conduct. It is trite law that subsequent conduct does not help in determining whether a contract was in place on a specific date, because the material consideration is whether the parties then thought there was a contract or not. However, subsequent conduct may add confusion in cases such as the present where the question is of spot trading. Specifically, where some terms of the contract have expressly been left for future determination, and where one party immediately proceeds to take such measures as to charter a vessel to be nominated under the contract or to open a letter of credit (in *Proton*, the documents to be presented under the letter of credit had not been specified).

The message of the judgment in *Proton* is that once the language of commitment has been deployed, such uncertainty, and the risks associated therewith, are for the parties to manage as best they can.

1. Consideration is defined as “An act, forbearance, or promise by one party to a contract that constitutes the price for which he buys the promise of the other (Dunlop v Selfridge [1915] AC 847 (HL).”, see Law J and EA Martin, *A Dictionary of Law* (7 ed.), OUP, 2009. [↑](#footnote-ref-1)
2. According to the maxim *ex turpi causa non oritur actio*, making contracts without a “just cause” illegal. [↑](#footnote-ref-2)
3. [2010] UKSC 14. [↑](#footnote-ref-3)
4. *Durham Tees Valley Airport v BMI Baby* [2010] EWCA Civ 485, [2011] 1 Lloyd’s Rep 68 at [54]. [↑](#footnote-ref-4)
5. Ibid at [1]. [↑](#footnote-ref-5)
6. [1987] 2 Lloyd's Rep 601. [↑](#footnote-ref-6)
7. Ibid p 613. [↑](#footnote-ref-7)
8. Ibid, at p 619. [↑](#footnote-ref-8)
9. [2014] EWHC 87 (Comm) [↑](#footnote-ref-9)
10. [2013] EWHC 2872 (Comm); for this case, see the author’s co-authored article Hjalmarsson, Johanna and Bek, Mateusz (2013) Deal or no deal? Proton Energy Group SA v Orlen Lietuva [2013] EWHC 2872 (Comm). *Shipping and Trade Law*, 13, (9), 6-8. [↑](#footnote-ref-10)
11. At a price of DTD + $0.15 per barrel cfr Tema. DTD was industry shorthand for the index price of Brent crude oil on the relevant specified dates, which in this case were the five days following the bill of lading date. [↑](#footnote-ref-11)
12. (ii) What was the identity of the buyer? If no buyer was identified, was there no contract? As to the identity of the buyer stated in the "firm offer", "Cirrus ... (Full trading name)" was most readily referable to "Cirrus Oil", rather than to "Woodfields" (which had recently changed its name from Cirrus Energy Services Ltd). Cirrus Oil was the company with which Glencore had previously concluded transactions. At the time of the negotiation of this crude oil transaction, there was only one company in existence whose name began with "Cirrus". An objective reading of that reference lead to the clear identification of the buyer as a company whose name begins with the word "Cirrus". [↑](#footnote-ref-12)
13. *Rossiter v Miller* (1878) 3 App Cas 1124. [↑](#footnote-ref-13)
14. *Proton* at [32]. [↑](#footnote-ref-14)
15. Ibid at [39]. [↑](#footnote-ref-15)