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Formalities in UK IT Contracts – Signatures Not Always Necessary

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Overview

In today's fast-paced world, particularly in the IT field, parties may not always realise when they have entered into a binding contract. The advent of e-mail and Internet-based commercial relationships has only made the problem of the "inadvertent" contract more common.

The problem is highlighted in a recent decision of the UK High Court, which shows that a signature on a piece of paper is not always required for a contract - or a contract variation - to come into existence. Contracts can arise where the parties reach agreement in correspondence and/ or start performing the terms of the contract.

The decision serves as a reminder that, to avoid being bound by unexpected contracts, parties to a negotiation should, where possible, not start performing any work until the proper paperwork is complete, and should make sure that any pre-contract correspondence is made "subject to contract." Parties should take particular care when operating in an environment where informal negotiations by e-mail are common. For example, problems frequently occur where:

- parties are negotiating small-scale volume licensing arrangements (where negotiations may take place very quickly and involve the e-mail exchange of contract terms); or
- having carefully and laboriously constructed a large-scale contract, the parties abandon all formalities when discussing and informally agreeing upon subsequent changes to the contract.

For those doing business in the U.S., we have also briefly covered the U.S. position on contracting formalities relevant to IT projects or transactions.

Background

The case in question is *Grant v Bragg*. Grant and Bragg were partners in business and equal shareholders in a company called Premier Resorts Limited. Unfortunately, their relationship broke down, and they started to negotiate terms on which Bragg would buy Grant's shares in the company, so they could go their separate ways.

Though a draft share-sale contract was prepared, the negotiations were protracted. Despite this, Bragg started to act as if the sale had been concluded, by changing the locks on the company offices and otherwise excluding Grant from the business. Eventually, in order to bring things to a head, Bragg wrote an e-mail to Grant offering to buy his shares on the terms set out in the draft contract. Two days later, Grant accepted this offer by reply e-mail. Subsequently, Bragg changed his mind and tried to argue that he was not obliged to buy Grant's shares, as no contract was ever signed.

Decision and Implications

The court sided with Grant and found that the parties had, by their e-mail exchange, concluded a contract under which Bragg was bound to buy the shares from Grant. The court noted that, by excluding Grant from the business, Bragg had been acting as if the transaction were already completed. In this context, it would not reflect commercial reality to find that there was no binding contract between the parties.

This pragmatic decision illustrates the risks of "jumping the gun" by acting out a contract before all formalities have been completed. While you may expect the law to be a stickler for paperwork, this is not always the case (though in some cases, such as where parties are transferring copyright rights or real estate, a signed written agreement is a necessary formality). As such, if parties to a negotiation are not careful in their actions and communications, they may find themselves bound by contractual obligations, even before they sign on the dotted line.

The same warning applies where the parties are negotiating to vary an existing contract (a common occurrence in any complex IT or services-based transaction). If the parties agree on an amendment in correspondence and start carrying out the amendment, then the amendment may become legally binding, even before any formal variation has been signed. This may be true even where the original contract specifies that variations must be in writing and signed by the parties (though, in this case, the party wishing to enforce the informal variation will need to show that the parties intended to override their general agreement on how variations should be made).

When managing negotiations on a complex IT or services-based arrangement (either at the start of the arrangement or on any subsequent variation), in order to avoid being bound by unexpected contractual obligations, you should:

- if possible, not start performing any work until the proper paperwork is signed;
- if, due to time pressures, some advance work is required, consider entering into a short letter of agreement to cover this work and clarify in the letter that you are not committing to the full project until a formal contract is signed; and
- avoid accepting contract terms (or agreeing to contract variations) by e-mail or other form of correspondence. Where contract terms are discussed in correspondence, the correspondence should always be made "subject to contract." Any draft contract terms should be labelled with the same words. While the phrase "subject to contract" is not a "magic pill" to prevent a contract from coming into existence, it does clearly express the parties' intention that they should not be bound by any obligations until they have signed a formal contract.

U.S. Position:

In the U.S. (as in the UK), absent a statute or express contractual language requiring otherwise, a legally binding contract can arise where parties in a negotiation have not signed a formal document memorializing their agreement.

Apart from this general rule, individual states have enacted their own statutes that set out specific situations where a signed writing is required for a contract to be legally enforceable. For example, both New York and California have enacted statutes adopting certain traditional Statute of Frauds provisions, such as the requirement that any agreement which cannot be fully performed within one year (e.g. licensing agreements for a term of greater than one year) must be signed and in writing. Additionally, all but one of the states (the exception being Louisiana) have adopted Article 2 of the Uniform Commercial

Code (with state-by-state modifications) which, among other things, requires that any contract for the sale of goods over US$500 be evidenced by a signed writing. Companies seeking to do business in any particular U.S. state should seek the advice of lawyers familiar with applicable state and federal laws.

Companies should also realize that a "signed writing" does not necessarily mean a document with a traditional signature (whether written or electronic). Some U.S. federal and state courts have held that typing one's name in an e-mail accepting the terms of a contract can constitute a writing for the purposes of satisfying certain statutory requirements. However, the various federal and state courts have not been unified on their approach to the question whether acceptance by e-mail is necessarily sufficient for statutory purposes, so the position will often depend on the court's interpretation of the content of the e-mail in question.

Given the ubiquity of e-mail correspondence in conducting commercial negotiations, companies seeking to do business in the U.S. should take active steps to control (to the extent possible) how and when they enter into binding contracts.

However, companies should note that any such steps, while helpful, will not provide absolute protection against inadvertent entry into a contract. In addition to following the general guidelines, where it is necessary to enter into any agreements prior to the finalization of definitive agreements (for example, term sheets, letters of intent, etc.), companies should consider the option of requiring such documents to contain express language stipulating that the parties have no legal obligations to each other (other than those specified in the agreement at hand) until the eventual signature of formal definitive agreements. However, it should be noted that such language is not conclusive and parties can still find themselves bound by their behavior to the terms of expressly non-binding agreements.
