



## **Exclusion and limitation clauses in business contracts**

**A presentation at 39 Essex Street on 07.10.09 by**

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## INTRODUCTION

- 1 Contracts for the supply of goods and services may be made between (a) businesses, (b) businesses and consumers and (c) other, non-commercial bodies<sup>1</sup>.
- 2 The general principles of contract law (e.g. incorporation of terms, misrepresentation etc) apply to all three categories.
- 3 As regards exclusion and limitation clauses, specific statutory provisions apply to categories (a) and (b). Unfair Contracts Terms Act 1977 (“UCTA 1977”) applies to business - business contracts (“business contracts”) in respect of terms as to contractual performance (Ss 6&7), misrepresentation (S8) and restriction of contractual remedies (S13)<sup>2</sup>. In addition, UCTA 1977 contains provisions (e.g. S3) applicable only to business – consumer contracts (“consumer contracts”). The Unfair Terms in Consumer Contracts Regulations 1999 (“UTCCR 1999”) apply to consumer contracts<sup>3</sup>.
- 4 UCTA 1977 does not define the term “business” but states that it includes *“a profession and the activities of any government department or local or public authority”* (whether or not carried out for profit)<sup>4</sup>.
- 5 This paper focuses on business contracts but includes a final section which lists in general terms some significant differences between the law applicable to business contracts and consumer contracts.

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<sup>1</sup> E.g. a private car sale between individuals

<sup>2</sup> The principal sections of UCTA 1977 are set out in Appendix 1

<sup>3</sup> The main provisions of UTCCR 1999 are set out in Appendix 2

<sup>4</sup> S14. Certain contracts, including international supply contracts and insurance contracts are excluded from UCTA 1977 (see S26 & Sched 1) and recently *Trident Turboprop (Dublin) Ltd v First Flight Couriers Ltd* [2009] EWCA Civ. 290. However insurance contracts are not excluded from UTCCR 1999 and exclusion/limited clauses in general insurance contracts are also regulated by FSA’s *Insurance Code of Business Sourcebook* (“ICOB”) 1.1.1.

- 6 Appendix 3 contains two factual scenarios of business contract cases which are intended to form the basis of group discussion at the presentation.

### THE UNDERLYING APPROACH

- 7 The courts' approach to the regulation of exclusion and limitation clauses in business contracts is markedly different from contracts involving consumers.

- 8 The most frequently quoted dictum in this respect is from Lord Wilberforce in *Photo Production Ltd v Securicor Transport Ltd*<sup>5</sup> ("*Photo Production*"):

*"in commercial matters generally, when the parties are not of unequal bargaining power, and when risks are normally borne by insurance, not only is the case for judicial intervention undemonstrated, but there is everything to be said for leaving the parties free to apportion the risk as they think fit and for respecting their decisions."*

- 9 More recently, the Court of Appeal has described the correct approach in business cases in the following way<sup>6</sup>:

*"Where experienced businessmen representing substantial companies of equal bargaining power negotiate an agreement, they may be taken to have had regard to the matters known to them. They should, in my view, be taken to be the best judge of the commercial fairness of the agreement which they have made, including the fairness of each of the terms in that agreement. They should be taken to be the best judge on the question whether the terms of the agreement are reasonable. The court should not assume that either is likely to commit his company to an agreement which he thinks is unfair, or which he thinks includes unreasonable terms. Unless satisfied that one party has, in effect, taken unfair advantage of the other – or that a term is so unreasonable that it cannot properly have been understood or considered – the court should not interfere."*

- 10 In *Granville Oil & Chemicals Ltd v Davis Turner & Co. Ltd*<sup>7</sup>, a strong commercially experienced panel of the Court of Appeal, through Tuckey LJ, took the opportunity to say:

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<sup>5</sup> [1980] AC 827

<sup>6</sup> *Watford Electronics v Sanderson* [2001] 1 All ER (Comm) 696 ("*Watford*")– Chadwick LJ

<sup>7</sup> [2003] EWCA Civ. 570 ("*Granville Oil*")

*“The 1977 Act [UCTA] obviously plays a very important role in protecting vulnerable consumers from the effects of draconian contract terms. But I am less enthusiastic about its intrusion into contracts between commercial parties of equal bargaining strength, who should generally be considered capable of being able to make contracts of their choosing and expect to be bound by their terms.”*

## **THE CONTROL MECHANISMS**

- 11 There are however a number of control mechanisms applied by the courts in business cases. Although the general approach is based on freedom of contract, the courts are not entirely non-interventionist.

### **Construction**

- 12 It is an accepted principle of construction, but not a rule of law, that an exemption or limitation clause will not be interpreted as extending to a situation which would defeat the main object of the contract or create commercial absurdity, despite the literal meaning of the words used<sup>8</sup>.

- 13 This is a strong, but nonetheless rebuttable, presumption explained on the following grounds<sup>9</sup>:

*“In determining the meaning of the language of a commercial contract .... the law ..... generally favours a commercially sensible construction. The reason for this approach is that a commercial construction is more likely to give effect to the intention of the parties. Words are therefore interpreted in the way in which a reasonable commercial person would construe them. And the standard of the reasonable commercial person is hostile to technical interpretations and undue emphasis on the niceties of language.”*

### **Remote possibilities**

- 14 In seeking to escape the effect of an exclusion or limitation clause a party may well wish to demonstrate that in certain specified circumstances the clause will work a serious injustice or even cause an absurd commercial result.

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<sup>8</sup> This approach has recently been described as “*The rejection of literalism*”: see *Internet Broadcasting Corp Ltd. v Mar LLC* [2009] EWHC 844 (Ch) (“*Internet Broadcasting*”)

<sup>9</sup> *Mannai Investment Co. Ltd v Eagle Star Life Ass. Co. Ltd* [1997] 749 @ 771 and *Sirius Int. Ins. Co Ltd v FAI Gen. Ins. Ltd* [2004] 1 WLR 3251 @ [19]. In *Internet Broadcasting* the court relied on this principle to construe an exemption clause so as not to cover a deliberate personal repudiatory breach by one party.

- 15 This is a legitimate forensic approach but it is worth noting that in *Regus (UK) Ltd v Epcot Solutions Ltd* [2008] EWCA Civ. 361 (“*Regus*”) @ [36] the Court of Appeal, through Rix LJ, expressly approved the “wise” words of Mance LJ in *Skipsredittforeningen v Emperor Navigation SA*<sup>10</sup>, a case considering the requirement of reasonableness in the context of an exclusion against misrepresentation, that:

*“... The court should, I think, take care to consider the clause as a whole in the light of the circumstances when the contract was made, in order to judge in the round whether it satisfies the requirement of reasonableness. The court should not be too ready to focus on remote possibilities or to accept arguments that a clause fails the test by reference to relatively uncommon or unlikely situations.”*

### **Plain English**

- 16 This feature, which has come to be referred to as part of a wider doctrine of transparency, indicates that, if the clause is clearly drafted and legibly presented (so that, for example, it is “*understandable by any intelligent businessman*”<sup>11</sup>), there is a better prospect that a court will be satisfied that the content is reasonable. The converse is, of course, also the case.

### **The relative legal or commercial sophistication of the parties**

- 17 In some business cases there may, of course, be an important dispute as to whether the customer is acting as a consumer within UCTA 1977 or UTCCR 1999<sup>12</sup>. However, even if not a consumer at law, there are relevant degrees of sophistication for a customer within the business category. A party may be found, on the evidence, to have been an “*intelligent and experienced businessman*”<sup>13</sup>. Another party may, for example, have had access to in-house or external legal advice at the time of contracting. Another may be genuinely inexperienced in trading on standard terms and have been taken for a ride by a shrewd or

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<sup>10</sup> [1997] 2 BCLC 398, see also *Messer UK Ltd v Thomas Hardy Packaging Ltd & Anr* [2002] EWCA Civ. 549 @ [26]

<sup>11</sup> *Rees-Hough Ltd v Redland Reinforced Plastics Ltd* (1985) 2 Con LR 109

<sup>12</sup> S12 UCTA 1977, Reg 1 UTCCR 1999 & see e.g. recently *Barclays Bank plc v Kufner* [2008] EWHC 2319 (Comm) (“*Barclays Bank*”)

<sup>13</sup> *Regus* (supra) [39]

opportunistic counterparty. In *St Albans City & District Council*<sup>14</sup>, it was said that:

*“Council officials are not, in the ordinary sense of the word businessmen, although it is hoped that they act in a businesslike way ..... They do not operate in the same commercial field as business.”*<sup>15</sup>

### **Time of assessment**

- 18 The enforceability of the clause is to be assessed as at the time the contract is made (and not, for example, when the alleged breach occurs) and on the basis of the parties’ actual and constructive knowledge at that time<sup>16</sup>.
- 19 It follows that, when considering the requirement of reasonableness, the court must consider the clause(s) and the contract as a whole and not merely those parts which are relevant to the alleged breach.
- 20 A further consequence of this point is that the circumstances of the particular alleged breach of contract are not relevant. What is relevant are the possible breaches which were, or ought reasonably to have been, within the contemplation of the parties at the time of contracting.

### **Onus of proof**

- 21 It is important to re-state that the onus of proving that an exclusion or limitation clause is “fair and reasonable” is on the party relying on it<sup>17</sup>. This means that a party relying on an exclusion or limitation clause must plead particulars of reasonableness and prove them by evidence. If this is

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<sup>14</sup> (supra) @ 708

<sup>15</sup> Law Comm. Cmd. No 292 says that consideration of relative bargaining position may involve questions such as whether the transaction was “unusual” for either or both parties.

<sup>16</sup> S11(1) UCTA 1977:

*“the term shall have been a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made”*

<sup>17</sup> S11(5) UCTA 1977

not done, a finding that the clause does not satisfy the requirement of reasonableness is “*inevitable*”<sup>18</sup>.

### **UCTA 1977 guidelines**

- 22 UCTA 1977 Sched 2 includes a non-exhaustive list of 5 “*matters to which regard is to be had in particular*” in an assessment of reasonableness<sup>19</sup>. Although Sched 2 refers only to Ss 6&7 UCTA 1977, the courts consider these matters in any assessment of reasonableness in this area<sup>20</sup>.

### **Relativity of bargaining position**

- 23 This is the first listed consideration in UCTA 1977 Sched 2 (see Appendix 1).
- 24 There are, of course, some instances where parties may be said to contract with equal bargaining power but many more in which there is an imbalance of some degree. The relativity of bargaining power is a spectrum. What matters as far as the law is concerned is the relative bargaining position in respect of the clause in question at the time of the contract and not the relative commercial standings of the parties in more general terms<sup>21</sup>.

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<sup>18</sup> *Astea (UK) Ltd v Time Group Ltd* [2003] EWHC 725

<sup>19</sup> In 2005 The Law Commission published its paper “*Unfair Terms in Contracts Law*” (“Law Comm. Cmd No. 292”) proposing a unified regime for business and consumer contracts saying however that it would expect the common factors to be applied differently in such distinct “settings”.

This report proposed (S14(4)) the following non-exhaustive list of relevant factors for assessment of the requirement of reasonableness:

- (a) the other terms of the contract
- (b) the terms of any other contract on which the contract depends
- (c) the balance of the parties’ interests
- (d) the risks to the party adversely affected by them
- (e) the possibility and probability of insurance
- (f) other ways in which the party adversely affected by the term might have been protected
- (g) the extent to which the term (whether alone or with others) differs from what would have been the case in its absence
- (h) the knowledge and understanding of the party adversely affected by the term
- (i) the strength of the parties’ bargaining position
- (j) the nature of the goods or services to which the contract relates”

<sup>20</sup> e.g. *Expo Fabrics UK Ltd v Martin* [2003] EWCA Civ. 1165 @ [18]

<sup>21</sup> It may, however, be relevant that a supplier is “*a very substantial company with ample resources to meet any [non-excluded and/or non-limited] liability*”; *St Albans City & District Council v International*

- 25 The power to negotiate the clause in question will depend on the particular circumstances of the contract in question, including its timing and subject-matter, the immediate needs of the parties at that time and extrinsic considerations such as the availability of the goods, services or credit the subject matter of the contract from third party suppliers (*“alternative means by which the customer’s requirements could have been met”*<sup>22</sup>).

### **Inducement**

- 26 This is the second listed consideration in UCTA 1977 Sched 2 (see Appendix 1).
- 27 The point is closely linked to considerations of actual knowledge and negotiation. If there is evidence that the contracting parties expressly considered the clause(s) and took it/them into account in fixing the other terms of the contract, including the price, this is powerful evidence in business cases that the clause(s) should be enforced. It is worth noting that the content of this point is deceptively wide in evidential terms since a relevant consideration for the court is whether the party seeking to escape the clause *“had an opportunity of entering a similar contract with other persons, but without having to accept a similar term”*.

### **Actual or constructive knowledge of the clause in question**

- 28 This is the third listed consideration in UCTA 1977 Sched 2 (see Appendix 1).

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*Computers Ltd* [1995] FSR 686 (*“St Albans City & District Council”*). In that case the local authority customer of computer software which had miscalculated Community Charge payments would have recovered most of its losses from local taxpayers by *“increased taxation or reduced services”* if its £1m+ claim against the supplier had been limited to the contractual figure of £100,000.

<sup>22</sup> UCTA 1977 Sched 2(a) & *Overseas Medical Supplies Ltd v Orient Transport Services* [1999] 2 Lloyd’s Rep 273 (*“Overseas Medical Supplies”*)



- 29 A finding of actual knowledge will be more persuasive than one of constructive knowledge on the issue of enforceability, at least in cases where the clause is not contained in standard business sector trading terms. The issue of knowledge extends not only to the “*existence*” of the clause in the contract but also to its “*extent*”.
- 30 Again, the content of this point may be wide in evidential terms given the admissibility of evidence as to previous dealings between the parties<sup>23</sup>.

#### **Practical compliance with condition subsequent**

- 31 This is the fourth listed consideration in UCTA 1977 Sched 2 (see Appendix 1).
- 32 A condition may, for example, provide for notification of a claim for loss within a specified period of time<sup>24</sup>. The assessment as to the practicality of compliance should, of course, be made as at the time of contract.

#### **Bespoke contract goods**

- 33 This is the fifth listed consideration in UCTA 1977 Sched 2 (see Appendix 1).
- 34 In this case, there may be a strong presumption that business parties will have turned their minds expressly to the particular risks associated with the specified goods and should be held to the express terms of contract.
- 35 On the other hand, a clause that excludes, or very significantly limits, a supplier’s liability arising from poor production of highly technical goods may not be reasonable where, for example, no reliable third party repairs to the goods can be undertaken either at all or at a realistic price<sup>25</sup>.

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<sup>23</sup> See e.g. *Regus @ [39], Watford* (supra) [48]

<sup>24</sup> See e.g. *Granville Oil.* (supra)

<sup>25</sup> *Edmund Murray Ltd v BSP Int. Foundations Ltd* (1992) 33 Con LR 1

## Insurance

- 36 Interestingly, the guidelines in Sched 2 UCTA 1977 do not refer to insurance<sup>26</sup>. Elsewhere in UCTA 1977 the availability of insurance is referred to only in relation to the assessment of limitation clauses. However, this feature is considered important by the courts in all cases<sup>27</sup>.
- 37 It has become commonplace for clauses to include an express term whereby the party seeking to rely on the clause “advises” the other to insure itself against the losses excluded or limited<sup>28</sup>.
- 38 It follows that the courts will consider evidence as to the availability and terms of relevant insurance as at the time of contract, in particular if such was discussed between the parties. This may include internal documentary disclosure from a party. However, because S11(1) UCTA 1977 provides that the relevant circumstances are those “*in the contemplation of the parties*” and not one party, a party’s actual insurance arrangements will not be relevant (unless disclosed at the time of the contract) whereas the availability of the relevant type(s) of insurance may be.
- 39 There is established authority for the general proposition, or starting point, that it is more realistic for the customer to obtain indemnity insurance than for the buyer to obtain liability insurance.
- “Either party can insure against [the loss]. It is generally more economical for the person by whom the loss will be directly sustained to do so rather than that it should be covered by the other party by liability insurance.”<sup>29</sup>*

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<sup>26</sup> “The possibility and probability of insurance” is listed in the unified guidelines proposed by Law Comm Cmd. No. 292

<sup>27</sup> S11(4)

<sup>28</sup> See e.g. *Regus* [41] where the clause read:

*“We will not in any circumstances have any liability for loss of business, loss of profits, loss of anticipated savings, loss of or damage to data, third party claims or any consequential loss. We strongly advise you to insure against all such potential loss, damage, expense or liability.”*

<sup>29</sup> *Photo Production* (supra) @ 851

40 In conventional cases of supply of goods and services and exclusion of indirect/consequential loss, this point is likely therefore to assist the supplier relying on the disputed clause<sup>30</sup>.

41 This judicial starting point does not, however, address the terms of such cover (e.g. premium and sum insured) if cover of the relevant type(s) is available.

### **Mutual use of exclusion and/or limitation clauses**

42 A number of reported cases indicate that the courts consider it relevant to inquire whether a party seeking to escape the effect of an exclusion or limitation clause has used similar clauses (e.g. excluding or limiting liability in respect of indirect or consequential losses) in its own business before or at the time of the contract in question<sup>31</sup>. The point, if proved, supports the conclusion that the express terms of the clause should be enforced. This point is stronger if the contract in question includes bilateral exclusion and/or limitation clauses operating (on other facts) in favour of the party seeking to escape the effect of the disputed clause.

43 It will be apparent that this consideration also opens up a potentially wide area for the admission of factual evidence and documentary disclosure.

### **Exclusion v. limitation**

44 Unsurprisingly, the courts will regard a limitation of liability clause with more sympathy, provided of course that the limit is objectively justifiable.

45 UCTA 1977 defines a limitation clause as being a term by which a party seeks to restrict its liability to a "*specified sum of money*"<sup>32</sup>. If a formula

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<sup>30</sup> In *Regus* [41], Rix LJ for the court made a more technical point saying that the supplier may have difficulty in providing liability underwriters with proper information about the different counterparty businesses concerned. Again, this strength of this point will be fact specific and depend on evidence.

<sup>31</sup> *Watford* (supra) [48], *Regus* (supra) [39]

<sup>32</sup> This form of words includes a formula; e.g.

is used, the factor in relation to which any limit is being considered must be an appropriate one. Potentially appropriate factors include: the turnover of the supplier or customer, the contract price or value, the foreseeable losses to the customer, the weight of the goods (where values may vary markedly). The size of the limit compared with other limits in widely used standard terms is also relevant<sup>33</sup>, as is evidence that the limit had been revised from time to time before the contract.

46 A limitation clause may be drafted so as to limit the remedies available to the customer (e.g. right to reject or set-off cross claims against the contract price). Whilst each case will ultimately depend on its facts there is a line of cases supporting the reasonableness of anti-set-off clauses in loan agreements; see e.g. *Barclays Bank*<sup>34</sup>, not least because they do not exclude or limit the scope of a remedy but do require a customer to pay before suing.

47 UCTA 1977 provides that the court “shall”, in addition to the Sched. 2 guidelines, consider the availability to the party relying on the clause of<sup>35</sup>:

- (1) resources for the purpose of meeting the liability;
- (2) insurance cover in respect of that liability.

48 These mandatory considerations may well operate to persuade a court that the requirement of reasonableness is not satisfied; for example in the case of a well-resourced supplier of goods or services, especially if

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- “up to a maximum of £1 million ... for damage to your personal property
  - up to a maximum equal to 125% of the total fees paid under the agreement up to the date on which the claim in question arises or £50,000 (whichever is the higher), in respect of all other losses, damages, expenses or claims.”

<sup>33</sup> *Overseas Medical Supplies* (supra)

<sup>34</sup> (supra) @ [35]: “Neither the set-off clause nor any other clause in the ... loan agreement bars [the customer] from making a claim against the Bank, and at the same time, the Bank has a legitimate commercial interest in receiving payment under the loan agreement when the same is due, instead of being kept out of its money whilst a cross-claim is litigated.”

<sup>35</sup> S11(4)

insurance cover (e.g. professional indemnity or product liability) is available.

### **The nature of the goods/services**

- 49 UCTA 1977 draws no distinction between different types of goods and services or the size or value of the goods and services the subject matter of the contract<sup>36</sup>.
- 50 UCTA was, of course, passed into law over 30 years ago and at a time when there was little experience of certain types of contract goods and services (e.g. I.T. software or database supply and/or consultancy) with the capacity to cause significant loss (direct and indirect/consequential) to the customer.

### **THE APPEAL PROCESS**

- 51 As stated above, application of the various control mechanisms used by the courts in business contracts are invariably contract and fact specific and therefore limited to the language of the contractual term(s) in question and the facts surrounding that contract.
- 52 It follows that, unless a court is prepared to rule on the enforceability of a standard clause in general, non-fact-specific terms, it is unlikely that reported first instance decisions will provide really useful assistance to the parties in resolving their disputes. Often as not, there will be distinguishing features. What then of appeal cases?
- 53 In *George Mitchell Ltd v Finney Lock Seeds Ltd*<sup>37</sup> the House of Lords, through Lord Bridge, said, in an extract often recited by the Court of Appeal, this of the appeal process in this area:

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<sup>36</sup> “The nature of the goods or services to which the contract relates” is listed in the unified guidelines proposed by Law Comm Cmd. No. 292

<sup>37</sup> [1983] 2 All ER 737 @ 743

*“There will sometimes be room for a legitimate difference of opinion as to what the answer should be, where it will be impossible to say that one view is demonstrably wrong and the other demonstrably right. It must follow ... that, when asked to review such a decision on appeal, the appellate court should treat the original decision with the utmost respect and refrain from interference with it unless satisfied that it proceeded upon some erroneous principle or was plainly and obviously wrong.”*

54 This approach is consistent with the current approach of the Court of Appeal to appeals on issues of fact; see e.g. *Assicurazioni Generali SpA v Arab Insurance Group*<sup>38</sup>. On one view of the reported decisions it can be said that the Court of Appeal will intervene to overturn an assessment on enforceability only if it concludes that the first instance judge has made an error of law, misconstrued the nature and scope of the clause itself and/or reached a commercially naïve or absurd decision<sup>39</sup>.

55 It follows from this approach that appellate decisions on the issue of reasonableness will also often provide only very limited guidance for the future. The Court of Appeal has on occasions said that it, or members of it, would have taken a different view from that taken by the trial judge but has declined to overturn the judgment on the basis of the latitude to be afforded to the first instance determination. On the other hand, appellate decisions may, for example, inform the parties as to the current thinking about the relevance of certain features, for example insurance and its different forms<sup>40</sup>.

## **CONSUMER CONTRACTS**

56 As indicated in paragraphs 7 – 10 above, the underlying approach to consumer contracts is different.

57 In more concrete terms, there is an important and wide ranging body of statutory law (part of UCTA 1977 and UTCCR 1999) that applies only to

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<sup>38</sup> [2003] 1 WLR 577

<sup>39</sup> A recent example of misconstruction is *Regus* (supra).

<sup>40</sup> e.g. *Regus* (supra) [41]

consumer contracts. The purpose of the following list is simply to identify a number of points at which the legal regimes diverge.

58 In consumer contracts, unlike business contracts:

- (1) All terms must be in “plain intelligible language”<sup>41</sup>;
- (2) Any supplier’s standard/non-negotiated contractual term (excluding the subject matter or price/remuneration)<sup>42</sup> has no contractual effect if it causes *“a significant imbalance in the parties’ rights and obligations arising under the contract, to the detriment of the consumer”*; (UTCCR 1999 Reg 5,8 & Sched 2 (“The Grey List”<sup>43</sup>) – App. 2)<sup>44</sup>;
- (3) A supplier may not by a contract term exclude his liability for breach of contract as to quality, correspondence with description or fitness for purpose; (S6(2) & 7(2) UCTA 1977 – App. 1)<sup>45</sup>;
- (4) A supplier in breach of contract cannot rely on an exclusion/limitation clause in its written standard terms of business to exclude or restrict his liability or claim to be entitled to render substantially different contractual

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<sup>41</sup> UTCCR Reg 7, Reg 6(2), *OFT v Foxtons Ltd* [2009] EWHC 1681 (Ch) @ [59]

<sup>42</sup> UTCCR 1999 Reg 6, Directive 93/13/EEC

<sup>43</sup> The issue is not reasonableness but “good faith” and “significant imbalance”.

In *Bryen & Langley Ltd v Boston* [2005] EWCA Civ 973 @ [45], the Court of Appeal said:

*“It follows, in my view, that in assessing whether a term that has not been individually negotiated is “unfair” for the purposes of Regulation 5(1) it is necessary to consider not merely the commercial effects of the term on the relative rights of the parties but, in particular, whether the term has been imposed on the consumer in circumstances which justify a conclusion that the supplier has fallen short of the requirements of fair dealing. The situation at which Regulation 5(1) is directed is one in which the supplier, who will normally be presumed to be in the stronger bargaining position, has imposed a standard form contract on the consumer containing terms which are, or might be said to be, loaded unfairly in favour of the supplier.”*

The Grey List, so-called because it sets out terms presumed but not deemed to cause imbalance, includes 17 wide ranging categories such as (m):

*“a term which has the object or effect of giving the seller or supplier the right to determine whether the goods or services are in conformity with the contract, or giving him the exclusive right to interpret any term of the contract.”*

<sup>44</sup> A recent high profile decision on UTCCR 1999 is *Abbey National Bank plc & Ors v OFT* [2009] EWCA Civ. 116 – the bank charges case; see esp. [23] – [92]. The consumer legislation and this decision apply to personal accounts but not to company or business/practice accounts.

<sup>45</sup> Again, the issue is not reasonableness.

performance or no performance unless that clause is reasonable; (S3 UCTA 1997 – App. 1)

- (5) A supplier may not by a contract term obtain from his customer an indemnity in respect of his breach of contract unless that clause is reasonable; (S4 UCTA 1977 – App.1)

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7th October 2009



## APPENDIX 1

### UNFAIR CONTRACT TERMS ACT 1977

Scope of Part I.

**1.—**(1) For the purposes of this Part of this Act, "negligence" means the breach—

(a) of any obligation, arising from the express or implied terms of a contract, to take reasonable care or exercise reasonable skill in the performance of the contract;

(b) of any common law duty to take reasonable care or exercise reasonable skill (but not any stricter duty);

1957 c. 31.

1957 c. 25. (N.I.).

(c) of the common duty of care imposed by the Occupiers' Liability Act 1957 or the Occupiers' Liability Act (Northern Ireland) 1957.

(2) This Part of this Act is subject to Part III; and in relation to contracts, the operation of sections 2 to 4 and 7 is subject to the exceptions made by Schedule 1.

(3) In the case of both contract and tort, sections 2 to 7 apply (except where the contrary is stated in section 6(4)) only to business liability, that is liability for breach of obligations or duties arising—

(a) from things done or to be done by a person in the course of a business (whether his own business or another's); or

(b) from the occupation of premises used for business purposes of the occupier;

and references to liability are to be read accordingly.

(4) In relation to any breach of duty or obligation, it is immaterial for any purpose of this Part of this Act whether the breach was inadvertent or intentional, or whether liability for it arises directly or vicariously.

Negligence liability.

**2.—**(1) A person cannot by reference to any contract term or to a notice given to persons generally or to particular persons exclude or restrict his liability for death or personal injury resulting from negligence.

(2) In the case of other loss or damage, a person cannot so exclude or restrict his liability for negligence except in so far as the term or notice satisfies the requirement of reasonableness.

(3) Where a contract term or notice purports to exclude or restrict liability for negligence a person's agreement to or awareness of it is not of itself to be taken as indicating his voluntary acceptance of any risk.

Liability arising in contract.

**3.—**(1) This section applies as between contracting parties where one of them deals as consumer or on the other's written standard terms of business.

(2) As against that party, the other cannot by reference to any contract term—

(a) when himself in breach of contract, exclude or restrict any liability of his in respect of the breach; or

(b) claim to be entitled—

(i) to render a contractual performance substantially different from that which was reasonably expected of him, or

(ii) in respect of the whole or any part of his contractual obligation, to render no performance at all,

except in so far as (in any of the cases mentioned above in this subsection) the contract term satisfies the requirement of reasonableness.

Unreasonable indemnity clauses.

**4.—**(1) A person dealing as consumer cannot by reference to any contract term be made to indemnify another person (whether a party to the contract or not) in respect of liability that may be incurred by the other for negligence or breach of contract, except in so far as the contract term satisfies the

requirement of reasonableness.

(2) This section applies whether the liability in question—

(a) is directly that of the person to be indemnified or is incurred by him vicariously;

(b) is to the person dealing as consumer or to someone else.

Sale and hire-  
purchase.

56 & 57 Vict. c. 71.

1973 c. 13.

**6.—**(1) Liability for breach of the obligations arising from—

(a) section 12 of the Sale of Goods Act 1983 (seller's implied undertakings as to title, etc.);

(b) section 8 of the Supply of Goods (Implied Terms) Act 1973 (the corresponding thing in relation to hire-purchase),

cannot be excluded or restricted by reference to any contract term.

(2) As against a person dealing as consumer, liability for breach of the obligations arising from—

(a) section 13, 14 or 15 of the 1893 Act (seller's implied undertakings as to conformity of goods with description or sample, or as to their quality or fitness for a particular purpose);

(b) section 9, 10 or 11 of the 1973 Act (the corresponding things in relation to hire-purchase),

cannot be excluded or restricted by reference to any contract term.

(3) As against a person dealing otherwise than as consumer, the liability specified in subsection (2) above can be excluded or restricted by reference to a contract term, but only in so far as the term satisfies the requirement of reasonableness.

(4) The liabilities referred to in this section are not only the business liabilities defined by section 1(3), but include those arising under any contract of sale of goods or hire-purchase agreement.

**7.—**(1) Where the possession or ownership of goods passes under or in pursuance of a contract not governed by the law of sale of goods or hire-purchase, subsections (2) to (4) below apply as regards the effect (if any) to be given to contract terms excluding or restricting liability for breach of obligation arising by implication of law from the nature of the contract.

(2) As against a person dealing as consumer, liability in respect of the goods' correspondence with description or sample, or their quality or fitness for any particular purpose, cannot be excluded or restricted by reference to any such term.

(3) As against a person dealing otherwise than as consumer, that liability can be excluded or restricted by reference to such a term, but only in so far as the term satisfies the requirement of reasonableness.

(4) Liability in respect of—

(a) the right to transfer ownership of the goods, or give possession; or

(b) the assurance of quiet possession to a person taking goods in pursuance of the contract,

cannot be excluded or restricted by reference to any such term except in so far as the term satisfies the requirement of reasonableness.

## **8. Misrepresentation**

If a contract contains a term which would exclude or restrict—

(a) any liability to which a party to a contract may be subject by reason of any misrepresentation made by him before the contract was made; or

(b) any remedy available to another party to the contract by reason of such a misrepresentation,  
that term shall be of no effect except in so far as it satisfies the requirement of reasonableness as stated in section 11(1) Unfair Contract Terms Act 1977; and it is for those claiming that the term satisfies that requirement to show that it does.

The  
"reasonableness"

1967 c. 7.

1967 c. 14 (N.I.).

**11.—**(1) In relation to a contract term, the requirement of reasonableness for the purposes of this Part of this Act, section 3 of the Misrepresentation Act 1967 and section 3 of the Misrepresentation Act (Northern Ireland) 1967 is that the term shall have been a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made.

(2) In determining for the purposes of section 6 or 7 above whether a contract term satisfies the requirement of reasonableness, regard shall be had in particular to the matters specified in Schedule 2 to this Act; but this subsection does not prevent the court or arbitrator from holding, in accordance with any rule of law, that a term which purports to exclude or restrict any relevant liability is not a term of the contract.

(3) In relation to a notice (not being a notice having contractual effect), the requirement of reasonableness under this Act is that it should be fair and reasonable to allow reliance on it, having regard to all the circumstances obtaining when the liability arose or (but for the notice) would have arisen.

(4) Where by reference to a contract term or notice a person seeks to restrict liability to a specified sum of money, and the question arises (under this or any other Act) whether the term or notice satisfies the requirement of reasonableness, regard shall be had in particular (but without prejudice to subsection (2) above in the case of contract terms) to—

(a) the resources which he could expect to be available to him for the purpose of meeting the liability should it arise; and

(b) how far it was open to him to cover himself by insurance.

(5) It is for those claiming that a contract term or notice satisfies the requirement of reasonableness to show that it does.

"Dealing as consumer".

**12.—**(1) A party to a contract "deals as consumer" in relation to another party if—

(a) he neither makes the contract in the course of a business nor holds himself out as doing so; and

(b) the other party does make the contract in the course of a business; and

(c) in the case of a contract governed by the law of sale of goods or hire-purchase, or by section 7 of this Act, the goods passing under or in pursuance of the contract are of a type ordinarily supplied for private use or consumption.

(2) But on a sale by auction or by competitive tender the buyer is not in any circumstances to be regarded as dealing as consumer.

(3) Subject to this, it is for those claiming that a party does not deal as consumer to show that he does not.

### **13. - Varieties of exemption clause**

(1) To the extent that this Part of this Act prevents the exclusion or restriction of any liability it also prevents--

(a) making the liability or its enforcement subject to restrictive or onerous conditions;

(b) excluding or restricting any right or remedy in respect of the liability, or subjecting a person to any prejudice in consequence of his pursuing any such right or remedy;

(c) excluding or restricting rules of evidence or procedure;

and (to that extent) sections 2 and 5 to 7 also prevent excluding or restricting liability by reference to terms and notices which exclude or restrict the relevant obligation or duty.

(2) But an agreement in writing to submit present or future differences to arbitration is not to be treated under this Part of this Act as excluding or restricting any liability.

## **26 International supply contracts**

(1) The limits imposed by this Act on the extent to which a person may exclude or restrict liability by reference to a contract term do not apply to liability arising under such a contract as is described in subsection (3) below.

(2) The terms of such a contract are not subject to any requirement of reasonableness under section 3 or 4: and nothing in Part II of this Act shall require the incorporation of the terms of such a contract to be fair and reasonable for them to have effect.

(3) Subject to subsection (4), that description of contract is one whose characteristics are the following—

(a) either it is a contract of sale of goods or it is one under or in pursuance of which the possession or ownership of goods passes; and

(b) it is made by parties whose places of business (or, if they have none, habitual residences) are in the territories of different States (the Channel Islands and the Isle of Man being treated for this purpose as different States from the United Kingdom).

(4) A contract falls within subsection (3) above only if either—

(a) the goods in question are, at the time of the conclusion of the contract, in the course of carriage, or will be carried, from the territory of one State to the territory of another; or

(b) the acts constituting the offer and acceptance have been done in the territories of different States; or

(c) the contract provides for the goods to be delivered to the territory of a State other than that within whose territory those acts were done.

## SCHEDULE 2

### "GUIDELINES" FOR APPLICATION OF REASONABLENESS TEST

The matters to which regard is to be had in particular for the purposes of sections 6(3), 7(3) and (4), 20 and 21 are any of the following which appear to be relevant—

- (a) the strength of the bargaining positions of the parties relative to each other, taking into account (among other things) alternative means by which the customer's requirements could have been met;
- (b) whether the customer received an inducement to agree to the term, or in accepting it had an opportunity of entering into a similar contract with other persons, but without having to accept a similar term;
- (c) whether the customer knew or ought reasonably to have known of the existence and extent of the term (having regard, among other things, to any custom of the trade and any previous course of dealing between the parties);
- (d) where the term excludes or restricts any relevant liability if some condition is not complied with, whether it was reasonable at the time of the contract to expect that compliance with that condition would be practicable;
- (e) whether the goods were manufactured, processed or adapted to the special order of the customer.



## **APPENDIX 2**

### **UNFAIR TERMS IN CONSUMER CONTRACTS REGULATIONS 1999**

#### Reg 1

"consumer" means any natural person who, in contracts covered by these Regulations, is acting for purposes which are outside his trade, business or profession;

"seller or supplier" means any natural or legal person who, in contracts covered by these Regulations, is acting for purposes relating to his trade, business or profession, whether publicly owned or privately owned;

"unfair terms" means the contractual terms referred to in regulation 5.

#### Reg 4

(1) These Regulations apply in relation to unfair terms in contracts concluded between a seller or a supplier and a consumer.

#### Reg 5

(1) A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer.

(2) A term shall always be regarded as not having been individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term.

(3) Notwithstanding that a specific term or certain aspects of it in a contract has been individually negotiated, these Regulations shall apply to the rest of a contract if an overall assessment of it indicates that it is a pre-formulated standard contract.

(4) It shall be for any seller or supplier who claims that a term was individually negotiated to show that it was.

(5) Schedule 2 to these Regulations contains an indicative and non-exhaustive list of the terms which may be regarded as unfair.

(6) Any contractual term providing that a consumer bears the burden of proof in respect of showing whether a distance supplier or an intermediary complied with any or all of the obligations placed upon him resulting from the Directive and any rule or enactment implementing it shall always be regarded as unfair.

#### Reg 6

(1) Without prejudice to regulation 12, the unfairness of a contractual term shall be assessed, taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances attending the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent.

(2) In so far as it is in plain intelligible language, the assessment of fairness of a term shall not relate--

- (a) to the definition of the main subject matter of the contract, or
- (b) to the adequacy of the price or remuneration, as against the goods or services supplied in exchange.

#### Reg 8

(1) An unfair term in a contract concluded with a consumer by a seller or supplier shall not be binding on the consumer.

(2) The contract shall continue to bind the parties if it is capable of continuing in existence without the unfair term.

#### Reg 9

These Regulations shall apply notwithstanding any contract term which applies or purports to apply the law of a non-Member State, if the contract has a close connection with the territory of the Member States.

#### Sched. 2

Indicative and non-exhaustive list of terms which may be regarded as unfair

Terms which have the object or effect of--

- (a) excluding or limiting the legal liability of a seller or supplier in the event of the death of a consumer or personal injury to the latter resulting from an act or omission of that seller or supplier;
- (b) inappropriately excluding or limiting the legal rights of the consumer vis-à-vis the seller or supplier or another party in the event of total or partial non-performance or inadequate performance by the seller or supplier of any of the contractual obligations, including the option of offsetting a debt owed to the seller or supplier against any claim which the consumer may have against him;
- (c) making an agreement binding on the consumer whereas provision of services by the seller or supplier is subject to a condition whose realisation depends on his own will alone;
- (d) permitting the seller or supplier to retain sums paid by the consumer where the latter decides not to conclude or perform the contract, without

providing for the consumer to receive compensation of an equivalent amount from the seller or supplier where the latter is the party cancelling the contract;

- (e) requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation;
- (f) authorising the seller or supplier to dissolve the contract on a discretionary basis where the same facility is not granted to the consumer, or permitting the seller or supplier to retain the sums paid for services not yet supplied by him where it is the seller or supplier himself who dissolves the contract;
- (g) enabling the seller or supplier to terminate a contract of indeterminate duration without reasonable notice except where there are serious grounds for doing so;
- (h) automatically extending a contract of fixed duration where the consumer does not indicate otherwise, when the deadline fixed for the consumer to express his desire not to extend the contract is unreasonably early;
- (i) irrevocably binding the consumer to terms with which he had no real opportunity of becoming acquainted before the conclusion of the contract;
- (j) enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract;
- (k) enabling the seller or supplier to alter unilaterally without a valid reason any characteristics of the product or service to be provided;
- (l) providing for the price of goods to be determined at the time of delivery or allowing a seller of goods or supplier of services to increase their price without in both cases giving the consumer the corresponding right to cancel the contract if the final price is too high in relation to the price agreed when the contract was concluded;
- (m) giving the seller or supplier the right to determine whether the goods or services supplied are in conformity with the contract, or giving him the exclusive right to interpret any term of the contract;
- (n) limiting the seller's or supplier's obligation to respect commitments undertaken by his agents or making his commitments subject to compliance with a particular formality;
- (o) obliging the consumer to fulfil all his obligations where the seller or supplier does not perform his;
- (p) giving the seller or supplier the possibility of transferring his rights and obligations under the contract, where this may serve to reduce the guarantees for the consumer, without the latter's agreement;
- (q) excluding or hindering the consumer's right to take legal action or exercise any other legal remedy, particularly by requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions, unduly restricting the evidence available to him or imposing on him a burden of proof which, according to the applicable law, should lie with another party to the contract.

## APPENDIX 3

### FACTUAL SCENARIOS

#### **A: Defective car components**

Company A is based in the Midlands and designs and manufactures precision engineered car components. Until 2008 it was a private family company with a turnover in the region of £5m gross pa. In 2008 it was bought out and became part of X plc, a successful publicly quoted engineering group.

For many years its regular customers have included car manufacturers, such as Nissan and Aston Martin in the UK and Peugeot in France. Nissan's regular practice was to produce a detailed specification for the components ordered and to provide Company A with written purchase orders incorporating its terms and conditions. These included lengthy exclusion and limitation clauses in prolix, legal language. Peugeot did something similar. There is no evidence that Company A's employees read these T&C when accepting orders for goods.

Aston Martin's practice was less formal since the company MDs had known each other for years. It was to e-mail an order to Company A stating only the product name and number, the quantity required and the requested delivery date.

Since 2000, the company's sale/supply contracts have included standard terms, drafted by a small solicitors' firm in Birmingham, which included the following clause:

"(1) We will not in any circumstances have any liability for loss of business, loss of profits, loss of anticipated savings, third party claims or any consequential loss.

(2) We shall be liable:

- Without limit for personal injury or death
- up to a maximum of £1 million (for any one event or series or connected events) for damage to your personal property
- up to a maximum equal to 125% of the total price paid under your contract up to the date on which the claim in question arises or £50,000 (whichever is the higher), in respect of all other losses, damages, expenses or claims."

Since 2008 all supplies by company A have been made on X's standard terms and conditions. These include exclusion clauses and a simple limitation clause in respect of a customer's indirect, consequential losses and third party claims in the sum of £100,000. There is no evidence that any buying company's employees read either T&C when ordering or accepting goods.

In 2006 Company A produced a large batch of products containing a latent defect which caused many of them to fracture and break whilst in use. Company A supplied defective products from this batch to Nissan, Aston Martin and Peugeot. The prices for these sales contracts were £30,000, £45,000 and £10,000 respectively.

During the period 2007 – 2009 a number of accidents occurred as a result of the defective components. In one accident an Aston Martin, driven in Knightsbridge by an under-employed investment banker, careered out of control into a bus queue seriously injuring a number of pedestrians and destroying a jeweller's shop window and closing its business for 1 month. The banker was himself seriously injured and is unable to work again. All injured and damaged parties have issued proceedings against Aston Martin.

All the customers have initiated a product recall of the cars affected and have replaced the items with components from a competing producer at significant cost.

Each company has written to Company A demanding reimbursement for any liability in respect of third party claims, recall costs and damages for loss of profit on lost sales due to negative press publicity.

**Questions:**

1. Do you consider that Company A will satisfy a court that the exclusion and/or limitation clause in question is enforceable against (a) Nissan, (b) Aston Martin and (c) Peugeot? What are the relevant considerations in reaching your view?
2. Would your view be the same if one of the components was supplied under these terms to a local car enthusiast who was re-building a car in his retirement and whose car was written off in an accident caused by the defect?

## **B: Defective software**

Company B is an English company owned and established by a U.S. management consultancy corporation. From 2005 employees of company B had worked with representatives of the National Health Service (“NHS”) to develop new computer software to integrate with existing programmes used by the NHS to improve the management of levels of bed occupancy and the stocks of expensive drugs held at a large teaching hospital. To manage bed occupancy, the programme required data as to occupying patients’ names and their in-patient medical histories.

In contract negotiations Company B consistently claimed that it was the only software company that could design a product that would achieve the NHS’ goals and told the NHS that patient data security would be enhanced and protected because the software could not be hacked into or modified by other software designers and manufacturers without knowledge of its programming language.

In 2006 a government report was published on wasted costs in the NHS and a number of national newspapers ran stories about the scandal of empty beds and poor drug stock management in its largest hospitals. The NHS came under intense central political pressure to demonstrate improved management of its bed and drug stock. Contract negotiations were significantly accelerated at the NHS’ request and a detailed contract signed within a week of the report. Company B and the NHS were both advised by reputable London commercial solicitors in the week before contract signing.

The contract was signed for a price of £0.75m with a term of 2 years. This price was significantly less than the sum first sought by company B but was agreed because the NHS said in contract negotiations that, if this contract was successful, it would appoint company B as its preferred bidder for similar contracts for all its hospitals.

Shortly before the contract was signed company B’s solicitors advised that the contract should contain an exclusion and limitation clause in the company’s favour. By that time it was public knowledge that a number of software suppliers were in dispute with the NHS and other government entities over IT contracts.

The contract incorporated the following term included for the first time in the final draft of the contract:

“(1) Subject to the limit provided in clause (2) below we will not in any circumstances have any liability for loss of business, loss of profits, loss of anticipated savings, loss of or damage to data, third party claims or any consequential loss. We strongly advise you to insure against all such potential loss, damage, expense or liability.

(2) We will be liable:

- In the event of a defect in the contract goods only up to the cost of repairing that defect provided always that we are given a first opportunity to repair it within 28 days of the defect arising and generally

- up to an aggregated maximum of 3 times the contract price in respect of any and all proven losses within clause (1) above.

When advising on the desirability of an exclusion and limitation clause, Company B's solicitors also asked it whether it had liability insurance cover against any claim by the NHS under the proposed contract. Company B said that it did not and would in any event not be able to obtain cover in the very short time before signing was demanded by the NHS. The solicitors then decided to insert the final sentence in clause (1) above. There was no discussion about insurance with the NHS.

The software was defective and did not achieve either of the stated ends. The NHS claims that its existing capability to manage bed occupancy has been compromised and that rectifying this problem has cost it a significant sum in management time in the region of £250,000. In addition, the failure in relation to drug stock management has caused it to purchase expensive drugs when not required and thereby incur unnecessary financing costs in the sum of about £3m. Finally, the software has mis-matched patients' names and their medical histories requiring the NHS to pay for a third party IT provider to re-write its patient database at the hospital.

### **Questions**

1. Do you consider that Company B will satisfy a court that the exclusion and/or limitation clause in question is enforceable? What are the relevant considerations in reaching your view?
2. Would your view be different if the US parent company was the contracting party?