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EXCLUSION CLAUSES

CENTRAL ISSUES

1. One of the most contentious boilerplate clauses in practice is an exclusion or limitation clause. This is particularly so in relation to liability for consequential losses. These losses can be enormous. Contracting parties generally wish both to contain and to control that risk. The clause that is generally used for this purpose is an exclusion or limitation clause (in this chapter the general term 'exclusion clause' will be used to refer to both exclusion and limitation clauses unless it is necessary to draw a distinction between an exclusion clause and a limitation clause in relation to the matter that is under discussion).
2. In order to perform its function an exclusion or limitation clause must (i) be validly incorporated into the contract, (ii) cover the loss which has been suffered, and (iii) survive scrutiny under the Unfair Contract Terms Act 1977, where that Act is applicable.
3. An exclusion or limitation clause must be drafted in clear terms if it is to be effective. In the past the courts interpreted exclusion clauses particularly strictly. The modern approach is to subject exclusion clauses to the ordinary rules of interpretation but it remains necessary for a lawyer drafting an exclusion clause to proceed with caution because remnants of the old restrictive rules remain.
4. The Unfair Contract Terms Act 1977, despite its rather misleading title, does not apply to all unfair terms in contracts. It applies to exclusion, limitation, and indemnity clauses.
5. Two fundamental issues arise when seeking to apply the 1977 Act to a contract term. The first may be termed a jurisdictional question, that is to say whether the Act applies to the term at all. Thus the court may be asked whether the clause is truly an exclusion clause or whether it is a clause that simply defines the obligations of the parties but does not purport to exclude liability for breach of an obligation. The second issue relates to the type of control that is applicable under the Act. Where the Act declares that the term is void no particular difficulty arises. On the other hand, where the clause is subject to a reasonableness test, then it can be a difficult matter to decide whether or not a term satisfies that test.

1. INTRODUCTION

Exclusion clauses can be portrayed as a social nuisance on the basis that they are a means by which contracting parties can seek to avoid the consequences of their failure to perform their contractual obligations. In this sense exclusion clauses provided an easy means by which a powerful party could exempt itself from any liability towards its contracting party. This was particularly so in relation to consumers. The infamous ticket cases in the late nineteenth century and the early part of the twentieth century (see, for example, *Parker* v. *South Eastern Railway* (1877) 2 CPD 416, at p. 324, Chapter 9, Section 3) demonstrated the willingness of business enterprises to make use of sweeping exemption clauses in their dealings with consumers. The problems presented by big business systematically excluding liability towards consumers continued well into the twentieth century, as can be demonstrated by cases such as *McCutcheon* v. *David MacBrayne Ltd* [1964] 1 WLR 125 (p. 331, Chapter 9, Section 3) and *Thornton* v. *Shoe Lane Parking Ltd* [1971] 2 QB 163 (p. 326, Chapter 9, Section 3). It is, however, a mistake to see exclusion and limitation clauses entirely in this negative light. They can play an important (and positive) role in the regulation of risk.

An example of the role played by exclusion clauses in the regulation of risk is provided by the case of *British Fermentation Products Ltd* v. *Compair Reavell Ltd* [1999] BLR 352. The defendant sellers agreed to supply and install a centrifugal air compressor at the purchaser's premises. The contract price was 'a little under £300,000'. The purchasers alleged that the compressor did not perform to its contractually agreed level. Further, they alleged that, while the sellers had attempted to remedy the fault, they had been unable to do so and that, in consequence, they had suffered loss. That loss took the form of increased operating costs for the life of the machine of £1,168,584 and also loss of capacity and/or downtime. Here it can be seen that the consequential losses were almost four times the size of the contract price. Some businesses cannot afford to bear that type of loss and so rely on exclusion or limitation clauses in order to contain their potential liability. The defence of the sellers in *British Fermentation Products* depended upon the relationship between three clauses in the contract. The first was condition 4 which made provision for the testing of the compressor and stated that, if the compressor failed to pass the test, the purchaser was entitled 'by notice in writing to reject the goods or such part thereof as shall have failed' the test. Secondly, condition 5 gave to the purchasers the right to replace goods which were rejected and, in such a case, the defendants agreed to pay to the purchasers 'any sum by which the expenditure reasonably incurred by the Purchaser in replacing the rejected goods exceeds the sum deducted' in order to reflect the value of the rejected goods. The claimants decided not to exercise their rights under either condition 4 or condition 5. The third clause relied upon by the defendants was condition 11 which stated:

> The vendor's liability under this condition or under condition 5 (Rejection and Replacement) shall be accepted by the Purchaser in lieu of any warranty or condition implied by law as to the quality or fitness for any particular purpose of the goods and save as provided in this condition the vendor shall not be under any liability to the Purchaser (whether in contract, tort or otherwise) for any defects in the goods or for any damage, loss, death or injury (other than death or personal injury caused by the negligence of the vendor as defined in section 1 of the Unfair Contract Terms Act 1977) resulting from such defects or from any work done in connection therewith.

Judge Bowsher QC held that this clause was effective to exclude the vendors' liability to the purchasers. In reaching this conclusion Judge Bowsher was heavily influenced by his perception of the commercial purpose of condition 11 seen in the context of the contract as a whole. He stated (at p. 358):

> It seems to me that the business common sense intention of the agreement as a whole is that the vendors undertake to supply a machine of the specification warranted, and if they fail in that undertaking the purchasers have an initial right to withdraw from the contract and reject the machine on terms that the vendors pay for them to buy from other suppliers a machine that is up to specification. If the purchasers so choose, there will be a period when the vendors will try to bring the machine up to specification, and those efforts again may be terminated by the purchasers by rejecting on the same agreed terms. If the purchasers still do not reject when the machine fails to come up to specification, the purchasers keep the machine but on terms that they do not complain thereafter of the failure to come up to specification. The amount of the damages claimed in this action compared with the purchase price shows the good business common sense of the contract. If the project is not successful, the purchasers have two opportunities to withdraw and buy a substitute machine of the standard warranted from another supplier at the vendor's expense, but they are not to be allowed to stand on the deal and charge the vendors enormous sums for their loss continuing for the life of the machine.

In the light of cases such as *British Fermentation Products* it is difficult to defend the view that exclusion clauses do not have a legitimate role to play in modern contract law. They clearly do play an important and valuable role in regulating and containing risk. The difficulty lies in determining when they perform a legitimate function and when they do not. In other words, exclusion and limitation clauses need to be regulated, not outlawed.

The nature of this regulation has changed over time. Prior to the enactment of the Unfair Contract Terms Act 1977 the courts did not have the power, at common law, to invalidate an exclusion or limitation clause on the ground that it was unreasonable. Lord Denning did attempt to formulate such a jurisdiction but his attempts in this regard were firmly rejected by the House of Lords. In the absence of a direct power to regulate unreasonable exclusion clauses the courts resorted to indirect means. The principal indirect means were the rules relating to the incorporation and interpretation of exclusion clauses. In cases such as *J Spurling Ltd* v. *Bradshaw* [1956] 1 WLR 461 (p. 326, Chapter 9, Section 3) and *Thornton* v. *Shoe Lane Park*ing *Ltd* [1971] 2 QB 163 (p. 326, Chapter 9, Section 3) the courts were able in effect to regulate an unreasonable exclusion clause by concluding that it had not been incorporated into the contract. The other device which the courts used was to apply to exclusion clauses particularly restrictive rules of interpretation so as to enable them to conclude that the clause did not in fact exempt the defendant from the particular loss that the plaintiff had suffered. Now that the Unfair Contract Terms Act 1977 has been enacted, the need for these indirect methods of control has largely disappeared. The Act can now do the job. While there are signs in the case-law that these old restrictive rules are on the way out (see, for example, *Bank of Credit and Commerce International SA* v. *Ali* [2001] UKHL 8, [2002] 1 AC 251, p. 409, Section 2) it cannot be said that they have disappeared (see, for example, *AEG (UK) Ltd* v. *Logic Resource Ltd* [1996] CLC 265, p. 328, Chapter 9, Section 3). The law is currently in a state of transition. The status of some of the old cases, which adopt a restrictive approach to the interpretation of exclusion clauses, is presently uncertain.

A contracting party which wishes to rely on an exclusion or limitation clause in order to exclude or limit its liability towards its contracting party must prove two matters and may be subject to challenge on a third issue. The first matter which the party relying on the exclusion clause must prove is that the clause has been validly incorporated into the contract. Incorporation has been discussed in Chapter 9. It is not necessary to go over this ground again. It suffices to note that many (but not all) of the cases discussed in Chapter 9 are cases concerned with the incorporation of exclusion clauses into a contract and that the courts have often been reluctant to conclude that an exclusion clause has been so incorporated. Exclusion clauses may be regarded as 'onerous' or 'unusual' and so attract the more stringent rules relating to the incorporation of terms into a contract (see generally *Interfoto Picture Library Ltd* v. *Stiletto Visual Programmes Ltd* [1989] QB 433, p. 323, Chapter 9, Section 3). But this is by no means a necessary inference. For example, a clause which limited the contractor's liability at a maximum of the contract price was held not to be 'onerous' or 'unusual' (see, for example, *Shepherd Homes Ltd* v. *Encia Remediation Ltd* [2007] EWHC 70 (TCC), [2007] BLR 135).

The second matter which a party relying upon an exclusion clause must prove is that the exclusion clause, as a matter of construction, is effective to exclude liability for the loss that the claimant has suffered. The principles applied by the courts when interpreting contract terms have been discussed in Chapter 11 but it is necessary here to examine some of the particular principles of interpretation that have been formulated in the context of cases concerned with the interpretation of exclusion clauses. The future of these principles is a matter of some doubt. But it cannot yet be said that they have disappeared.

The third matter relates to the Unfair Contract Terms Act 1977. A party relying on an exclusion clause does not have to prove that the clause is valid under the Act. It is for the party challenging the validity of the clause to prove that it falls within its scope but, once he does so, the onus of proof switches to the party relying upon the clause to prove that it is reasonable (at least in those cases in which the clause is subject to the reasonableness test).

2. INTERPRETATION

In the past the courts applied extremely restrictive rules to the interpretation of exclusion and limitation clauses. In essence what the courts did was to apply the *contra proferentem* principle with particular venom to exclusion clauses. *Contra proferentem* is a principle of general application in contract law. It is not confined to exclusion clauses (see *Tan Wing Chuen* v. *Bank of Credit and Commerce Hong Kong Ltd* [1996] 2 BCLC 69, 77) and it provides that, in the event of there being an ambiguity in a contract term, the ambiguity is to be resolved against the party relying upon the term. Thus an ambiguously drafted exclusion clause is ineffective to exclude liability, at least in the case where it is not clear whether the clause covers the loss that has been suffered. This is not an unreasonable result. But the principle was applied in an unreasonable way in an attempt to create an ambiguity in order to apply the rule (see, for example, *Wallis, Son and Wells* v. *Pratt and Haynes* [1911] AC 394 and *Andrews Bros (Bournemouth) Ltd* v. *Singer and Co Ltd* [1934] 1 KB 17). These old cases may now have been overruled. In *Investors Compensation Scheme Ltd* v. *West Bromwich Building Society* [1998] 1 WLR 896, 912 (see pp. 373–376, Chapter 11, Section 3) Lord Hoffmann stated that 'almost all the old intellectual baggage of "legal" interpretation

has been discarded'. The significance of this sentence for the interpretation of exclusion and limitation clauses was explained by Lord Hoffmann in his dissenting speech in *Bank of Credit and Commerce International SA* v. *Ali* [2001] UKHL 8, [2002] 1 AC 251 in the following terms:

57. It was however unusual, even in the 19th century, for commercial documents to be interpreted according to rules of construction. The quest for certainty, which still dominated the construction of wills and deeds, was thought less important than the need to give effect to the actual commercial purpose of the document. There was however one remarkable example in the 20th century of a rule of construction being evolved by the courts in a commercial context. This was the rule for construing exemption clauses. But the purpose was different from that of most of the rules applied to wills and deeds. It was not to promote certainty of construction but to remedy the unfairness which exemption clauses could create. As Mr Allen [counsel for Mr Naeem] also contended for a rule of construction on grounds of fairness, I think that the story of the rise and fall of the rule of construction for exemption clauses may be instructive.

58. A vivid account of what happened was given by Lord Denning MR in *George Mitchell (Chesterhall) Ltd* v. *Finney Lock Seeds Ltd* [1983] QB 284, 296–297:

> 'None of you nowadays will remember the trouble we had—when I was called to the Bar—with exemption clauses. They were printed in small print on the back of tickets and order forms and invoices. They were contained in catalogues or timetables. They were held to be binding on any person who took them without objection. No one ever did object. He never read them or knew what was in them. No matter how unreasonable they were, he was bound. All this was done in the name of "freedom of contract". But the freedom was all on the side of the big concern which had the use of the printing press. No freedom for the little man who took the ticket or order form or invoice. The big concern said, "Take it or leave it". The little man had no option but to take it. The big concern could and did exempt itself from liability in its own interest without regard to the little man. It got away with it time after time. When the courts said to the big concern, "You must put it in clear words", the big concern had no hesitation in doing so. It knew well that the little man would never read the exemption clauses or understand them…
>
> Faced with this abuse of power—by the strong against the weak—by the use of the small print of the conditions—the judges did what they could to put a curb upon it. They still had before them the idol, "freedom of contract". They still knelt down and worshipped it, but they concealed under their cloaks a secret weapon. They used it to stab the idol in the back. This weapon was called "the true construction of the contract". They used it with great skill and ingenuity. They used it so as to depart from the natural meaning of the words of the exemption clause and to put upon them a strained and unnatural construction. In case after case, they said that the words were not strong enough to give the big concern exemption from liability; or that in the circumstances the big concern was not entitled to rely on the exemption clause. If a ship deviated from the contractual voyage, the owner could not rely on the exemption clause. If a warehouseman stored the goods in the wrong warehouse, he could not pray in aid the limitation clause. If the seller supplied goods different in kind from those contracted for, he could not rely on any exemption from liability. If a shipowner delivered goods to a person without production of the bill of lading, he could not escape responsibility by reference to an exemption clause. In short, whenever the wide words—in their natural meaning—would give rise to an unreasonable result, the judges either rejected them as repugnant to the main purpose of the contract, or else cut them down to size in order to produce a reasonable result.'

59. Lord Denning went on, at pp. 298–299 to explain that everything had now changed as a result of the passing of the Unfair Contract Terms Act 1977. 'We should no longer have to go

through all kinds of gymnastic contortions to get round them'. A few years earlier, in *Photo Production Ltd* v. *Securicor Transport Ltd* [1980] AC 827, 843 Lord Wilberforce had said much the same thing:

> 'There was a large number of problems, productive of injustice, in which it was worse than unsatisfactory to leave exception clauses to operate. Lord Reid referred to these in *Suisse Atlantique Société d'Armement Maritime SA* v. *NV Rotterdamsche Kolen Centrale* [1967] 1 AC 361, 406, pointing out at the same time that the doctrine of fundamental breach was a dubious specific. But since then Parliament has taken a hand: it has passed the Unfair Contract Terms Act 1977. This Act applies to consumer contracts and those based on standard terms and enables exception clauses to be applied with regard to what is just and reasonable. It is significant that Parliament refrained from legislating over the whole field of contract. After this Act, 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, and this seems to have been Parliament's intention, for leaving the parties free to apportion the risks as they think fit and for respecting their decisions.'

60. My Lords, the lesson which I would draw from the development of the rules for construing exemption clauses is that the judicial creativity, bordering on judicial legislation, which the application of that doctrine involved is a desperate remedy, to be invoked only if it is necessary to remedy a widespread injustice. Otherwise there is much to be said for giving effect to what on ordinary principles of construction the parties agreed...

62. The disappearance of artificial rules for the construction of exemption clauses seems to me in accordance with the general trend in matters of construction, which has been to try to assimilate judicial techniques of construction to those which would be used by a reasonable speaker of the language in the interpretation of any serious utterance in ordinary life. In *Investors Compensation Scheme Ltd* v. *West Bromwich Building Society* [1998] 1 WLR 896, 912, I said with the concurrence of three other members of the House: 'Almost all the old intellectual baggage of "legal" interpretation has been discarded'. But if Mr Allen's submissions on the rules of construction are accepted, a substantial piece of baggage will have been retrieved. Lord Keeper Henley's ghost (*Salkeld* v. *Vernon*, 1 Eden 64) will have struck back. I think it would be an unfortunate retreat into formalism if the outcome of this case were to require employers using the services of Acas to add verbiage to the form of release in order to attain the comprehensiveness which it is obviously intended to achieve.

Further support for the proposition that modern courts are willing to cast off the baggage of restrictive rules of interpretation can be found in the decision of the House of Lords in *Fiona Trust and Holding Corp* v. *Privalov* [2007] UKHL 40, [2008] 1 Lloyd's Rep 254. There it was held that the time had come to adopt a fresh approach to the interpretation of arbitration clauses and that the scope of an arbitration clause should not depend, as it has in the past, on supposed differences between phrases such as 'arising out of' or 'arising under' the contract.

Two factors may, however, be said to cast doubt over the authority of Lord Hoffmann's approach in *BCCI*. The first is that it is clearly *obiter* because *BCCI* v. *Ali* was a case concerned with the interpretation of a release, not the interpretation of an exemption clause. The second is the fact that Lord Hoffmann's speech was a dissenting speech. However it is suggested that this factor cannot be decisive because Lord Hoffmann was in fact providing a gloss on his own speech in *Investors Compensation Scheme* and there he was speaking for the majority of their Lordships.

The crucial question that must now be answered by the courts is this: has Lord Hoffmann's statement in *Investors Compensation Scheme* that 'almost all the old intellectual baggage of "legal" interpretation has been discarded' had the effect of overruling all the old cases in which 'artificial rules' for the interpretation of exclusion clauses were adopted? The cases post-*Investors Compensation Scheme* do provide some support for a more relaxed approach to the interpretation of exclusion clauses and judges have cited *Investors Compensation Scheme* when adopting a more clement approach (see, for example, *Whitecap Leisure Ltd* v. *John H Rundle Ltd* [2008] EWCA Civ 429, [2008] 2 Lloyd's Rep 216, [20]; *National Westminster Bank* v. *Utrecht-America Finance Co* [2001] EWCA Civ 658, [2001] 3 All ER 733 and *British Fermentation Products Ltd* v. *Compair Reavell Ltd* [1999] BLR 352, p. 406, Section 1). But it may be too soon to write the obituary for the old rules applicable to the interpretation of exclusion clauses. Some of the cases in which these rules were enunciated have been approved by appellate courts and cannot easily be swept aside.

(a) EXCLUDING LIABILITY IN NEGLIGENCE

There is one particular context in which the old rules may have survived and that is in the case where one party relies on an exclusion clause in order to exclude or limit liability for his own negligence. The rules or, more accurately, the principles applied by the courts when deciding whether or not a party has effectively excluded liability for his own negligence or the negligence of his employees were authoritatively stated by Lord Morton of Henryton in *Canada Steamship Lines Ltd* v. *The King* [1952] AC 192, 208 in the following terms:

> Their Lordships think that the duty of a court in approaching the consideration of such clauses may be summarized as follows:-
>
> (1) If the clause contains language which expressly exempts the person in whose favour it is made (hereafter called 'the proferens') from the consequence of the negligence of his own servants, effect must be given to that provision . . .
>
> (2) If there is no express reference to negligence, the court must consider whether the words used are wide enough, in their ordinary meaning, to cover negligence on the part of the servants of the proferens. If a doubt arises at this point, it must be resolved against the proferens . . .
>
> (3) If the words used are wide enough for the above purpose, the court must then consider whether 'the head of damage may be based on some ground other than that of negligence', to quote again Lord Greene in the *Alderslade* case [1945] KB 189, 192. The 'other ground' must not be so fanciful or remote that the proferens cannot be supposed to have desired protection against it; but subject to this qualification, which is no doubt to be implied from Lord Greene's words, the existence of a possible head of damage other than that of negligence is fatal to the proferens even if the words used are prima facie wide enough to cover negligence on the part of his servants.

The first of these three principles is not problematic. If a clause 'expressly exempts' a party from the consequences of his or his employees' negligence then the clause is effective, as a matter of interpretation, to exclude liability for negligence. In order to constitute an express reference to negligence it does not suffice for a party to use general words such as 'loss however caused' or 'damage howsoever arising'. The word 'negligence' or a synonym

for negligence (such as carelessness) must be used (see *Shell Chemicals UK Ltd* v. *P & O Roadtanks Ltd* [1995] 1 Lloyd's Rep 297, 301).

The problem lies with the second and the third principles because they rest on the dubious assumption that parties do not intend to use general words such as 'loss howsoever caused' to cover both negligently inflicted loss and non-negligently inflicted loss. One would have thought that the natural inference to be drawn from the use of such general words is that the precise cause of the loss is irrelevant so that the clause is apt to encompass loss whether or not it is caused by negligence. But this is not the approach taken by the courts. According to the third principle, general words will only be effective to exclude liability for negligently inflicted loss in the case where the only realistic loss likely to be suffered by the claimant is loss suffered as a result of the negligence of the defendants. Where there is a realistic possibility that the defendant might be liable to the claimant either in negligence or on some other basis then the scope of the exclusion clause will generally be confined to the non-negligent source of liability and leave the defendant with no protection at all in the event that the claimant suffers loss as a result of the negligence of the defendant. The impact of these rules at work can be demonstrated by reference to the following case:

Hollier v. Rambler Motors (AMC) Ltd
[1972] 2 QB 71, Court of Appeal

The plaintiff brought an action for damages against the defendant garage after his car had been badly damaged in a fire at the defendants' garage. The fire was caused by the defendants' negligence. The car had been left with the defendants so that repair work could be undertaken. The defendants sought to rely on an exclusion clause contained in an invoice which stated that 'The company is not responsible for damage caused by fire to customers' cars on the premises'. The Court of Appeal held that the exclusion clause had not been validly incorporated into the contract with the plaintiff and for that reason it was ineffective to exclude liability to the plaintiff (see p. 334, Chapter 9, Section 4). This sufficed to decide the case but the judges nevertheless went on to consider whether the clause was effective, as a matter of construction, to exclude the defendants' liability in negligence. They concluded that it was not.

Salmon LJ [held that the clause had not been incorporated into the contract and continued]

That really disposes of this appeal, but in case I am wrong on the view that I have formed, without any hesitation, I may say, that the course of dealing did not import the so-called exclusion clause, I think I should deal with the point as to whether or not the words on the bottom of the form, had they been incorporated in the contract, would have excluded the defendants' liability to compensate the plaintiff for damage caused to the plaintiff's car by a fire which in turn had been caused by the defendants' own negligence. It is well settled that a clause excluding liability for negligence should make its meaning plain on its face to any ordinarily literate and sensible person. The easiest way of doing that, of course, is to state expressly that the garage, tradesman or merchant, as the case may be, will not be responsible for any damage caused by his own negligence. No doubt merchants, tradesmen, garage proprietors and the like are a little shy of writing in an exclusion clause quite so bluntly as that. Clearly it would not tend to attract customers, and might even put many off. I am not saying that an exclusion clause cannot be effective to exclude negligence unless it does so expressly, but in order for the clause to be effective the language should be so plain

that it clearly bears that meaning. I do not think that defendants should be allowed to shelter behind language which might lull the customer into a false sense of security by letting him think—unless perhaps he happens to be a lawyer—that he would have redress against the man with whom he was dealing for any damage which he, the customer, might suffer by the negligence of that person.

The principles are stated by Scrutton LJ with his usual clarity in *Rutter* v. *Palmer* [1922] 2 KB 87, 92:

> 'For the present purposes a rougher test will serve. In construing an exemption clause certain general rules may be applied: First the defendant is not exempted from liability for the negligence of his servants unless adequate words are used; secondly, the liability of the defendant apart from the exempting words must be ascertained; then the particular clause in question must be considered; and if the only liability of the party pleading the exemption is a liability for negligence, the clause will more readily operate to exempt him.'

Scrutton LJ was far too great a lawyer, and had far too much robust common sense, if I may be permitted to say so, to put it higher than that 'if the only liability of the party pleading the exemption is a liability for negligence, the clause will more readily operate to exempt him'. He does not say that 'if the only liability of the party pleading the exemption is a liability for negligence, the clause will necessarily exempt him'. After all, there are many cases in the books dealing with exemption clauses, and in every case it comes down to a question of construing the alleged exemption clause which is then before the court. It seems to me that in *Rutter* v. *Palmer,* although the word 'negligence' was never used in the exemption clause, the exemption clause would have conveyed to any ordinary, literate and sensible person that the garage in that case was inserting a clause in the contract which excluded their liability for the negligence of their drivers. The clause being considered in that case—and it was without any doubt incorporated in the contract—was: 'Customers' cars are driven by your staff at customers' sole risk'. Any ordinary man knows that when a car is damaged it is not infrequently damaged because the driver has driven it negligently. He also knows, I suppose, that if he sends it to a garage and a driver in the employ of the garage takes the car on the road for some purpose in connection with the work which the customer has entrusted the garage to do, the garage could not conceivably be liable for the car being damaged in an accident unless the driver was at fault. It follows that no sensible man could have thought that the words in that case had any meaning except that the garage would not be liable for the negligence of their own drivers. That is a typical case where, on the construction of the clause in question, the meaning for which the defendant was there contending was the obvious meaning of the clause.

The next case to which I wish to refer is the well-known case of *Alderslade* v. *Hendon Laundry Ltd* [1945] 1 KB 189. In that case articles were sent by the plaintiff to the defendants' laundry to be washed, and they were lost. In an action by the plaintiff against the defendants for damages, the defendants relied on the following condition to limit their liability: 'The maximum amount allowed for lost or damaged articles is 20 times the charge made for laundering'. Again, this was a case where negligence was not expressly excluded. The question was: what do the words mean? I have no doubt that they would mean to the ordinary housewife who was sending her washing to the laundry that, if the goods were lost or damaged in the course of being washed through the negligence of the laundry, the laundry would not be liable for more than 20 times the charge made for the laundering. I say that for this reason. It is, I think, obvious that when a laundry loses or damages goods it is almost invariably because there has been some neglect or default on the part of the laundry. It is said that thieves break in and steal, and the goods (in that case handkerchiefs) might have been stolen by thieves. That of course is possible, but I should hardly think that a laundry would be a great

allurement to burglars. It is a little far-fetched to think of burglars breaking into a laundry to steal the washing when there are banks, jewellers, post offices, factories, offices and homes likely to contain money and articles far more attractive to burglars. I think that the ordinary sensible housewife, or indeed anyone else who sends washing to the laundry, who saw that clause must have appreciated that almost always goods are lost or damaged because of the laundry's negligence, and therefore this clause could apply only to limit the liability of the laundry, when they were in fault or negligent.

But Mr Tuckey [counsel for the defendants] has drawn our attention to the way in which the matter was put by Lord Greene MR in delivering the leading judgment in this court, and he contends that Lord Greene MR was in fact making a considerable extension to the law as laid down by Scrutton LJ in the case to which I have referred. For this proposition he relies on the following passage in Lord Greene MR's judgment, at p. 192:

> 'The effect of those authorities can I think be stated as follows: Where the head of damage in respect of which limitation of liability is sought to be imposed by such a clause is one which rests on negligence and nothing else, the clause must be construed as extending to that head of damage, because it would otherwise lack subject matter.'

If one takes that word 'must' au pied de la lettre that passage does support Mr Tuckey's contention. However, we are not here construing a statute, but a passage in an unreserved judgment of Lord Greene MR, who was clearly intending no more than to re-state the effect of the authorities as they then stood . . . I do not think that Lord Greene MR was intending to extend the law in the sense for which Mr Tuckey contends. If it were so extended, it would make the law entirely artificial by ignoring that rules of construction are merely our guides and not our masters; in the end you are driven back to construing the clause in question to see what it means. Applying the principles laid down by Scrutton LJ, they lead to the result at which the court arrived in *Alderslade* v. *Hendon Laundry Ltd* [1945] 1 KB 189. In my judgment these principles lead to a very different result in the present case. The words are: 'The company is not responsible for damage caused by fire to customers' cars on the premises'. What would that mean to any ordinarily literate and sensible car owner? I do not suppose that any such, unless he is a trained lawyer, has an intimate or indeed any knowledge of the liability of bailees in law. If you asked the ordinary man or woman: 'Supposing you send your car to the garage to be repaired, and there is a fire, would you suppose that the garage would be liable?' I should be surprised if many of them did not answer, quite wrongly: 'Of course they are liable if there is a fire'. Others might be more cautious and say: 'Well, I had better ask my solicitor', or, 'I do not know. I suppose they may well be liable'. That is the crucial difference, to my mind, between the present case and *Alderslade* v. *Hendon Laundry Ltd* and *Rutter* v. *Palmer* [1922] 2 KB 87. In those two cases, any ordinary man or woman reading the conditions would have known that all that was being excluded was the negligence of the laundry, in the one case, and the garage, in the other. But here I think the ordinary man or woman would be equally surprised and horrified to learn that if the garage was so negligent that a fire was caused which damaged their car, they would be without remedy because of the words in the condition. I can quite understand that the ordinary man or woman would consider that, because of these words, the mere fact that there was a fire would not make the garage liable. Fires can occur from a large variety of causes, only one of which is negligence on the part of the occupier of the premises, and that is by no means the most frequent cause. The ordinary man would I think say to himself: 'Well, what they are telling me is that if there is a fire due to any cause other than their own negligence they are not responsible for it'. To my mind, if the defendants were seeking to exclude their responsibility for a fire caused by their own negligence, they ought to have done so in far plainer language than the language here used.

Stamp LJ

On the question of construction, I reach the same conclusion as Salmon LJ, but by, I think, a slightly different route. As I understand the law, it is settled that where in a contract such as this you find a provision excluding liability capable of two constructions, one of which will make it applicable where there is no negligence by the defendant, and the other will make it applicable where there is negligence by the defendant, it requires special words or special circumstances to make the clause exclude liability in case of negligence: see, for example, *Price & Co* v. *Union Lighterage Co* [1904] 1 KB 412. Similarly, I would hold that, where the words relied upon by the defendant are susceptible either to a construction under which they become a statement of fact in the nature of a warning or to a construction which will exempt the defendant from liability for negligence, the former construction is to be preferred. The words here, 'the company is not responsible for damage caused by fire to customers' cars on the premises', are, in my judgment, certainly susceptible to a construction which would regard them as a mere statement in the nature of a warning, and reinforced by the principle that I have stated, I would hold that that is how they ought to be construed in this case. If this be correct, I do not find it necessary to consider the cases which have been decided upon the footing that the clause under consideration was a term of the contract excluding some liability: for on the view that I have formed, the clause on its true construction is not a clause of that nature.

Latey J delivered a concurring judgment.

Commentary

The first paragraph from the judgment of Salmon LJ emphasizes the importance of using clear words. A party who wishes to exclude liability for negligence should say so expressly and then effect will be given to the clause (subject now to the Unfair Contract Terms Act 1977, on which see pp. 421–445, Section 3). On the other hand, a party who is 'shy' of making express reference to negligence in his exclusion clause runs the risk that his clause will be held to be ineffective, as a matter of construction, to exclude liability for negligence. This may be a reasonable conclusion to reach if the aim of the law is to require parties wishing to exclude liability for their own negligence to use the word 'negligence' expressly in their clause. But it seems unreasonable if the aim is to give effect to the intention of the parties because it denies to parties the ability to use words such as 'loss howsoever arising' if they wish to be sure that they have excluded liability for negligently inflicted harm. The law does not conclude that such general words are always ineffective to exclude liability for negligence because liability was effectively excluded in both *Rutter* v. *Palmer* and *Alderslade* v. *Hendon Laundry Ltd* (both of which are discussed in the judgment of Salmon LJ). But it is very difficult to have any confidence in the effectiveness of such general words. This can be demonstrated by contrasting the facts of *Rutter* v. *Palmer* with *Hollier*. What would have been the position in *Hollier* if the car had gone on fire after being involved in a crash caused by the negligence of one of the defendants' employees? Would such a case fall within the scope of *Rutter* or *Hollier*? It is impossible to be sure.

The basic flaw in the *Canada Steamship* rules is the assumption that contracting parties do not intend to use general words of exclusion to cover both negligently inflicted loss and non-negligently inflicted loss. This 'assumption' does not take the form of a rule of law. As Salmon LJ stated in *Hollier* 'rules of construction are merely our guides and not our masters'.

It is therefore open to a court to conclude that a clause is effective to exclude liability for negligence under the third limb of *Canada Steamship* notwithstanding the fact that it was possible to envisage some other possible source of liability to which the clause might potentially apply (see *The Raphael* [1982] 2 Lloyd's Rep 42). But the more realistic the alternative source of liability, the less likely it is that the court will conclude that general words are effective to exclude liability for negligently inflicted loss (see *EE Caledonia Ltd* v. *Orbit Valve Co Europe* [1994] 1 WLR 1515).

The *Canada Steamship* rules cannot easily be cast aside. They have been applied by the House of Lords (*Smith* v. *South Wales Switchgear Ltd* [1978] 1 WLR 165) and by the Court of Appeal on numerous occasions (see, for example, *EE Caledonia Ltd* v. *Orbit Valve Co Europe* [1994] 1 WLR 1515). It is therefore highly unlikely that a single sentence expressed in general terms in *Investors Compensation Scheme*, combined with Lord Hoffmann's elaboration in *BCCI* v. *Ali*, will suffice to overrule the *Canada Steamship* line of authority. Yet the relationship between *Investors Compensation Scheme* and *Canada Steamship* is an uneasy one. This can be demonstrated by reference to the decision of the Court of Appeal in *National Westminster Bank* v. *Utrecht-America Finance Company* [2001] EWCA Civ 733, [2001] 3 All ER 733 where Clarke LJ acknowledged that Lord Morton's tests remained 'valuable tools' but on the other hand concluded that there was 'no room' for their application to the clause in issue between the parties. Why was there this reluctance to apply the tests? The only possible answer seems to be that the *Canada Steamship* tests can fail to give effect to the intentions of the parties. This is particularly so in relation to a clause that excludes liability for damage 'howsoever caused'. As has been noted, this does not count as an express reference to negligence within limb one of the *Canada Steamship* tests and so will only be effective to exclude liability for negligence where there is no other realistic source of liability that can fall within the scope of the clause. In other words, the tests are based on the assumption that the parties did not intend to encompass more than one type of loss within the same clause. Yet where the parties use the words 'howsoever caused' surely this is their intention. The Australian courts have departed from the *Canada Steamship* rules. In *Schenker & Co (Aust) Pty Ltd* v. *Malpas Equipment and Services Pty Ltd* [1990] VR 834, McGarvie J concluded (at p. 846) that:

> to construe commercial contracts as they would be understood by business people serves primary aims of both the law and commerce. The law serves the community best if citizens understand it and are able to resolve their dispute themselves by reference to it, without resorting to lawyers.

The first sentence from this quotation very much reflects the sentiments of Lord Hoffmann's re-statement in *Investors Compensation Scheme* and, in principle, there is much to be said for it. But it is an approach that must lead to the overruling of the *Canada Steamship* line of authority and, if this is to be done, it should be done explicitly and not left to implication. This would leave the regulation of exclusion clauses largely to the control of the Unfair Contract Terms Act 1977. Support for such a proposition can be derived from the speech of Lord Diplock in *Photo Production Ltd* v. *Securicor Transport Ltd* [1980] AC 827, 851 when he stated:

> My Lords, the reports are full of cases in which what would appear to be very strained constructions have been placed upon exclusion clauses, mainly in what to-day would be called consumer contracts and contracts of adhesion. As Lord Wilberforce has pointed out, any need for this kind of judicial distortion of the English language has been banished by Parliament's having made these kinds of contracts subject to the Unfair Contract Terms Act

> 1977. In commercial contracts negotiated between business-men capable of looking after their own interests and of deciding how risks inherent in the performance of various kinds of contract can be most economically borne (generally by insurance), it is, in my view, wrong to place a strained construction upon words in an exclusion clause which are clear and fairly susceptible of one meaning only.

Adoption of this approach must surely lead to the demise of the *Canada Steamship* rules. They are part of the 'intellectual baggage' which Lord Hoffmann is seeking to discard on the basis that they are 'artificial' or, in the words of Lord Diplock, 'strained'.

However the House of Lords has refused to discard the *Canada Steamship* rules. Instead they have retained them while emphasizing that the paramount task of the court is to give effect to the intention of the parties (see *HIH Casualty and General Insurance Ltd* v. *Chase Manhattan Bank* [2003] UKHL 6, [2003] 2 Lloyd's Rep 61 at [11], [61]–[63], [95], and [116]). The approach of their Lordships was best summed up by Lord Bingham in the following passage (at [11]):

> There can be no doubting the general authority of [Lord Morton's principles], which have been applied in many cases, and the approach indicated is sound. The courts should not ordinarily infer that a contracting party has given up rights which the law confers upon him to an extent greater than the contract terms indicate he has chosen to do; and if the contract terms can take legal and practical effect without denying him the rights he would ordinarily enjoy if the other party is negligent, they will be read as not denying him those rights unless they are so expressed as to make clear that they do.

On this basis Lord Morton's rules may express no more than a judicial reluctance to conclude that one party has agreed to exempt the other party from the consequences of his negligence or to indemnify him for negligent conduct for which he was responsible (*Colour Quest Ltd* v. *Total Downstream UK plc* [2009] EWHC 540 (Comm), [2009] 2 Lloyd's Rep 1, [369]), although this reluctance does not manifest itself with the same vigour in the case where the clause seeks to limit (rather than exclude) liability for negligently inflicted harm (*Biffa Waste Services Ltd* v. *Maschinenfabrik Ernst Hese GmbH* [2008] EWHC 6 (TCC), [2008] BLR 155, [188]). This reluctance is understandable but it does not justify the *Canada Steamship* rules, in particular the operation of the second and the third rules. These rules should be discarded and the courts should instead be left free to give the words in the contract their natural and ordinary meaning. This being the case, words such as 'howsoever caused' or 'howsoever arising' should ordinarily be effective to exclude liability in negligence.

(b) FUNDAMENTAL BREACH

The doctrine of fundamental breach gave rise to a considerable amount of difficulty in the 1960s and 1970s. It was, essentially, a device that was used by the courts in order to control unreasonable exclusion clauses before they were given statutory jurisdiction to do so in the Unfair Contract Terms Act 1977. The principal architect of the doctrine was Lord Denning. In *Harbutt's Plasticine Ltd* v. *Wayne Tank and Pump Co Ltd* [1970] 1 QB 447, 467 Lord Denning MR stated:

> when one party has been guilty of a fundamental breach of the contract, that is, a breach which goes to the very root of it, and the other side accepts it, so that the contract comes to

> an end—or if it comes to an end anyway by reason of the breach—then the guilty party cannot rely on an exemption or limitation clause to escape from his liability for the breach.

The importance of this statement lies in the assertion that, as a matter of law, a party cannot rely on an exclusion or limitation clause where he has committed a fundamental breach of the contract. In making this statement Lord Denning was purporting to summarize the decision of the House of Lords in *Suisse Atlantique Société d'Armement Maritime SA* v. *NV Rotterdamsche Kolen Centrale* [1967] 1 AC 361. His summary was demonstrably faulty. The House of Lords in *Suisse Atlantique* laid down no such rule. It is admittedly not entirely easy to extract a clear ratio from the lengthy judgments of the House of Lords in that case but it is tolerably clear that their conclusion was that fundamental breach was a rule of construction not a rule of law. In other words, it was a rule that stated, the more serious the breach, the clearer the words that have to be used in order to exclude liability for the breach. This reflects the ordinary, common sense perception that one party is unlikely to agree that the other party can breach the contract in a fundamental respect without incurring any liability for doing so. The House of Lords did not state that, as a matter of law, one party cannot exclude or limit liability for a fundamental breach of contract.

That this was so was confirmed by the House of Lords in *Photo Production Ltd* v. *Securicor Transport Ltd* [1980] AC 827. The House of Lords overruled *Harbutt's Plasticine* and held that the question whether or not an exclusion or limitation clause is effective to exclude or limit liability is, in all cases, a question of construction. In doing so, their Lordships did not deny that Lord Denning's version of fundamental breach had performed a useful function in the past, but they concluded that it was no longer necessary in the light of the enactment of the Unfair Contract Terms Act 1977. Thus Lord Wilberforce acknowledged (at p. 843) that the 'doctrine of "fundamental breach" in spite of its imperfections and doubtful parentage [had] served a useful purpose' but went on, in the passage quoted by Lord Hoffmann in *BCCI* v. *Ali* (p. 409, at the beginning of Section 2) to state that there was no longer any need for the doctrine in the light of the enactment of the Unfair Contract Terms Act.

In *George Mitchell (Chesterhall) Ltd* v. *Finney Lock Seeds Ltd* [1983] 2 AC 803 Lord Bridge stated (at p. 813) that *Photo Production* 'gave the final quietus to the doctrine that a "fundamental breach" of contract deprived the party in breach of the benefit of clauses in the contract excluding or limiting his liability.' Further, as Neill LJ stated in *Edmund Murray Ltd* v. *BSP International Foundations Ltd* (1993) 33 Con LR 1, 16:

> it is always necessary when considering an exemption clause to decide whether as a matter of construction it extends to exclude or restrict the liability in question, but, if it does, it is no longer permissible at common law to reject or circumvent the clause by treating it as inapplicable to 'a fundamental breach'.

Although fundamental breach no longer exists as a rule of law, it can still give rise to the occasional difficulty. For example, in *Internet Broadcasting Corporation* v. *MAR LLC* [2009] EWHC 844 (Ch), [2009] 2 Lloyd's Rep 295, Deputy Judge Moss QC stated that 'there is a presumption, which appears to be a strong presumption, against the exemption clause being construed so as to cover deliberate, repudiatory breach.' However in *Astrazeneca UK Ltd* v. *Albemarle International Corporation* [2011] EWHC 1574 (Comm), [2011] All ER (D) 162 (Jun), Flaux J was extremely critical of the reasoning of the Deputy Judge, stating that it effectively sought to 'revive the doctrine of fundamental breach'. He labelled the judgment

'heterodox and regressive' and concluded that there is no such presumption. The question in each case is one of construction of the clause in question. That exercise is a strict one, in the sense that clear words are required in order to exclude liability in respect of the consequences of a deliberate breach, but it is an exercise in construction and one which is undertaken without the aid of a presumption.

(c) LIMITATION CLAUSES

There is authority to the effect that limitation clauses are not interpreted as restrictively as exclusion clauses. In *Ailsa Craig Fishing Co Ltd* v. *Malvern Fishing Co Ltd* [1983] 1 WLR 964 Lord Fraser of Tullybelton stated (at p. 970):

> There are . . . authorities which lay down very strict principles to be applied when considering the effect of clauses of exclusion or of indemnity . . . In my opinion these principles are not applicable in their full rigour when considering the effect of clauses merely limiting liability. Such clauses will of course be read contra proferentem and must be clearly expressed, but there is no reason why they should be judged by the specially exacting standards which are applied to exclusion and indemnity clauses. The reason for imposing such standards on these clauses is the inherent improbability that the other party to a contract including such a clause intended to release the proferens from a liability that would otherwise fall upon him. But there is no such high degree of improbability that he would agree to a limitation of the liability of the proferens, especially when . . . the potential losses that might be caused by the negligence of the proferens or its servants are so great in proportion to the sums that can reasonably be charged for the services contracted for. It is enough in the present case that the clause must be clear and unambiguous.

The justification put forward in support of this difference in treatment between exclusion clauses and limitation clauses is not particularly convincing. The improbability of a party agreeing to an exclusion clause is not necessarily much greater than the improbability of a party agreeing to a limitation clause. Much depends upon the size of the limitation clause. A limitation clause of £1 is very similar to a total exclusion of liability. In *BHP Petroleum Ltd* v. *British Steel plc* [2000] 2 Lloyd's Rep 277 Evans LJ stated (at p. 285):

> I think it is unfortunate if the present authorities cannot be reconciled on the basis that no categorization is necessary and of a general rule that the more extreme the consequences are, in terms of excluding or modifying the liability which would otherwise arise, then the more stringent the Court's approach should be in requiring that the exclusion or limit should be clearly and unambiguously expressed. Indeed, if the requirement is of a clear and unambiguous provision, then it is not easy to see why degrees of clarity and lack of unambiguity should be recognized.

(d) INDIRECT OR CONSEQUENTIAL LOSS

The final point relates to the meaning of the phrase 'indirect or consequential loss'. As has been noted (p. 406, Section 1), claims for consequential losses can be enormous. This being the case, parties frequently wish to exclude liability for consequential losses and they often

do so by excluding liability for 'indirect or consequential loss' in order to keep liability within acceptable bounds. But what does this phrase mean? Its meaning has been considered by the Court of Appeal on a number of occasions. One such case is *Hotel Services Ltd* v. *Hilton International Hotels (UK) Ltd* [2000] BLR 235. The parties entered into a contract under which the defendants agreed to supply the claimants with 'Robobars' for their hotels. A 'Robobar' was a hotel minibar which automatically recorded any removal of its contents and at the same time electronically registered the item concerned on the account of the guest. The attraction for the claimants was the obvious one, namely that it was hoped that it would reduce the incidence of theft from hotel minibars. Unfortunately, the Robobars proved to be defective in that their chillers leaked ammonia which corroded the equipment and also created a very small risk of injury to guests in the hotel. The claimants therefore removed the Robobars from their hotels and brought an action for damages against the defendants, in which they claimed the cost of removal and storage of the chiller units and cabinets and their loss of profit on the minibars. The defendants relied on an exclusion clause in the following terms:

> The Company will not in any circumstances be liable for any indirect or consequential loss, damage or liability arising from any defect in or failure of the System or any part thereof or the performance of this Agreement or any breach hereof by the Company or its employees.

The issue before the Court of Appeal was whether or not this clause was effective to exclude liability for the losses claimed by the claimants. The Court of Appeal held that it was not. The important distinction that must be drawn in this context is between a 'direct' loss (which is outside the scope of the exclusion clause) and an 'indirect' loss (which is within its scope). As a matter of authority the line between direct and indirect or consequential losses is drawn along the boundary between the first and second limbs of the rule in *Hadley* v. *Baxendale* (1854) 9 Exch 341 (discussed in more detail at pp. 868–869, Chapter 23, Section 8(a)). In other words, if the loss is such as may fairly and reasonably be considered as arising naturally from the breach of contract ('limb one'), it is a direct loss. On the other hand, if the loss is such as may reasonably be supposed to have been in the contemplation of both parties at the time of entry into the contract ('limb two'), it is an indirect or consequential loss. Although the task of distinguishing between limb one of *Hadley* v. *Baxendale* and limb two is not always an easy one (see further p. 874, Chapter 23, Section 8(a)), the Court of Appeal did not experience any difficulty in applying it to the facts of the present case. Thus Sedley LJ stated (at p. 241) that:

> we prefer . . . to decide this case . . . on the direct ground that if equipment rented out for selling drinks without defalcations turns out to be unusable and possibly dangerous, it requires no special mutually known fact to establish the immediacy both of the consequent cost of putting it where it can do no harm and—if when in use it was showing a direct profit—of the consequent loss of profit. Such losses are not embraced by the exclusion clause, read in its documentary and commercial context.

The loss of profit claim on the facts of the case amounted to £127,000, yet it was all held to be a direct consequence of the breach and so not within scope of the exclusion clause. The clause was only effective to exclude liability for losses of profit that were not direct but were nevertheless recoverable because they were within the contemplation of both parties at the time of entry into the contract (as in *Victoria Laundry (Windsor) Ltd* v. *Newman Industries Ltd* [1949] 2 KB 528, p. 871, Chapter 23, Section 8(a)). This being the case, a clause which excludes liability for 'indirect or consequential losses' will provide very little protection for a defendant because

many sizeable loss of profit claims will fall within the category of 'direct' rather than 'indirect' losses. If the intention of the defendant is to exclude liability for loss of profits suffered by the claimant then the exclusion or limitation clause should make express reference to the exclusion of loss of profit claims and not rely on general words of uncertain scope, such as 'indirect or consequential loss'. That said, there may be some hope for defendants who rely on such clauses. In *Caledonia North Sea Ltd* v. *British Telecommunications plc* [2002] UKHL 4, [2002] 1 Lloyd's Rep 553, Lord Hoffmann stated (at [100]) that he wished to 'reserve the question of whether, in the context of the contracts in the *Hotel Services* and similar cases, the construction adopted by the Court of Appeal was correct'. This remark is not sufficient to overturn the line of authority represented by *Hotel Services*. These cases therefore remain good law. But they may not survive scrutiny in the Supreme Court. The current uncertainty surrounding the meaning of the phrase 'indirect or consequential loss' is unfortunate given the widespread reliance upon the phrase in practice and the size of many consequential loss claims.

3. THE UNFAIR CONTRACT TERMS ACT 1977

The Unfair Contract Terms Act 1977 made major changes to the law relating to exclusion clauses in that it declared certain exclusion clauses ineffective and subjected others to a reasonableness test. The Act was based on a report prepared by the Law Commission for England and Wales and the Scottish Law Commission. The impact of the Act has been considerable but it is now under review by both Law Commissions. The immediate cause of this revision of the Act is the enactment of the Unfair Terms in Consumer Contracts Regulations 1994, later revoked and replaced by the Unfair Terms in Consumer Contracts Regulations 1999. The scope of these Regulations is discussed in Chapter 14. The relationship between the Act and the Regulations has been an uneasy one. The two pieces of legislation overlap and the Law Commissions have recommended (Law Commission Consultation No 292 and Scottish Law Commission No 199, discussed in more detail at pp. 490–493, Chapter 14, Section 5) that the Act and the Regulations be replaced by a unified regime. We shall return to these recommendations after we have discussed both the Act and the Regulations. The remainder of this chapter will focus exclusively upon the Act and the case-law which it has generated.

The approach that will be taken is to set out the Act section by section. Each section will be followed by a brief commentary. It will then conclude with consideration of two illustrative cases.

Before examining the first section of the Act it is necessary to make two preliminary points. The first is that the Act is divided into three Parts. Part I applies to England, Wales, and Northern Ireland. Each section in this Part, with the exception of section 8 (which is discussed at p. 623, Chapter 17, Section 6) will be given brief consideration. Part II applies to Scotland. We shall not examine Part II, except for a comparison between section 17 and section 3. Part II has many similarities with Part I but it is not identical. The failure to produce a unified regime for the whole of the United Kingdom is an unfortunate feature of the 1977 Act and it is a defect which the Law Commissions intend to rectify. Part III consists of a miscellany of provisions which apply to the whole of the United Kingdom. We shall examine some but not all of the sections in this Part. The second point to note is that the Act only comes into play where it has been demonstrated that the defendant is in some way liable to the claimant. This being the case, it is important first of all to identify the basis upon which the defendant is liable to the claimant before proceeding to apply the Act to the facts of the case. If, for example, the liability of the defendant is in negligence, then the applicable section will be section 2 of the Act. If, on the other hand, the liability is for breach of contract it

will be section 3 or, in the case of a contract for the sale of goods, section 6. The Act does not regulate liability in the abstract; it regulates liability in respect of recognized causes of action and it is vital first to identify the basis upon which the defendant is liable to the claimant.

The text of Part I of the Act is as follows:

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);

(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;

(c) and references to liability are to be read accordingly but liability of an occupier of premises for breach of an obligation or duty towards a person obtaining access to the premises for recreational or educational purposes, being liability for loss or damage suffered by reason of the dangerous state of the premises, is not a business liability of the occupier unless granting that person such access for the purposes concerned falls within the business purposes of the occupier.

(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.

Commentary

This section provides us with two important definitions and it also draws attention to the fact that certain contracts are excluded from the scope of the Act. The first definition is the definition of 'negligence' in subsections (1) and (4). Three points should be noted about this definition. The first is that it assumes that a liability has arisen on the part of the defendant because it refers to a 'breach' of an obligation to use reasonable care. This being the case, an exclusion clause which has the effect of negating the existence of the duty of care would appear to be outside the scope of the Act because the effect of such a clause is to prevent a duty from arising in the first place. A defendant who does not owe a duty of care to a claimant cannot be liable to that claimant. And, if he is not liable, there appears to be nothing on which the Act can bite because there has been no 'breach' of any 'duty of care'. As we shall see, the courts have not been receptive to a submission that the effect of a clause is to prevent a duty of care from arising with the consequence that the Act is inapplicable (see *Smith* v. *Eric S Bush* [1990] 1 AC 831 and *Phillips Products Ltd* v. *Hyland* [1987] 1 WLR 659, p. 449, Section 4). Secondly, 'negligence' encompasses both contractual negligence (that is to say

breach of a contractual duty to exercise reasonable care) and tortious negligence (that is to say liability which has arisen in tort rather than contract). Notwithstanding the title of the Act it is not confined to liability for breach of contract. It can apply to notices which purport to exclude liability, even in the absence of a contract between the parties (see section 2 of the Act extracted later in this section). Thirdly, subsection (4) expands the definition of negligence by making it clear that it does not matter whether the breach was inadvertent or intentional or whether liability for it arose directly or vicariously. Vicarious liability arises where one party is held liable for the wrongdoing of another. The principal example of vicarious liability in this context is the liability of an employer for the negligence of his employee.

The second definition is located in subsection (3), which makes it clear that the Act only applies to attempts to exclude or restrict business liability as defined in the subsection. An attempt by one party to exclude liability towards another in the context of a purely private sale (for example, the sale by one member of the public to another of a motor car or some other item) is generally outside the scope of the Act. 'Business' is defined in section 14 (p. 440, later in this section).

The third point to note is the exclusion, referred to in subsection (2), of certain contracts from the scope of the Act. These contracts are referred to in Schedule 1 (p. 443, later in this section).

Avoidance of liability for negligence, breach of contract, etc

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.

Commentary

A number of points arise in relation to the scope of section 2. The first is that it applies both to contract terms and to notices. Notice is defined in section 14 (p. 441, later in this section). The principal point to note in this context is that it encompasses non-contractual notices so that the Act is not confined in its application to contract terms. A notice on land purporting to exclude liability for damage caused by negligence can be subject to the Act (at least if the liability that is sought to be excluded falls within the definition of business liability in s. 1(3), discussed earlier). Secondly section 2 only applies to attempts to exclude liability for 'negligence' and negligence is defined in section 1. Here it is important to recall that negligence means the 'breach' of an obligation to exercise reasonable care. The section cannot therefore apply to attempts to exclude or restrict strict liability, that is to say, liability that arises irrespective of fault. Thirdly, the section only applies to clauses which 'exclude or restrict' liability. It does not apply to a clause that simply 'transfers' a liability from one party to another (*Thompson* v. *T Lohan (Plant Hire) Ltd* [1987] 1 WLR 649). The distinction between a clause

which 'excludes or restricts' a liability and a clause which 'transfers' a liability is discussed further later (at pp. 455–456, Section 4).

Fourthly, any attempt to exclude liability for death or personal injury caused by negligence is ineffective (section 2(1)). The court is not given a choice in the matter: the Act states that it is not possible to exclude liability for such losses. Personal injury is defined in section 14 (p. 441, later in this section). Fifthly, in the case of other loss or damage a term or notice which purports to exclude liability in negligence is valid only if it satisfies the requirement of reasonableness (section 2(2)). Reasonableness is defined in section 11 (p. 432, later in this section). Finally, section 2(3) has been enacted in order to prevent the protection of section 2 being outflanked by a party relying on the term or notice for the purpose of establishing the defence of *volenti non fit injuria*.[1] Reliance cannot be placed on the term or notice in order to establish that the claimant consented to the risk of suffering injury and, consequently, has no claim. A defendant who wishes to rely on the defence of *volenti* must do more than point to the existence of the term or notice and the claimant's awareness of it or agreement to it. This being the case, section 2(3) makes it extremely difficult for a defendant to make out the defence of *volenti*.

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.

Commentary

Section 3 regulates attempts to exclude or restrict liability for breach of contract. Once again, a number of points must be noted. First, it is vital to note that the section only applies to two types of contract and these are defined in subsection (1). The phrase 'deals as consumer' is defined in section 12 and we shall discuss its meaning there (pp. 438–439, later in this section). Here it is necessary to explore the meaning of the phrase 'deals . . . on the other's written standard terms of business'. This phrase is of considerable importance because it is the gateway to the application of the Act to commercial contracts. Commercial contracts concluded on terms which are not 'the other's written standard terms of business' are not regulated by this section. The meaning of this phrase has been explored in a number of cases.

The first is *Chester Grosvenor Hotel Co Ltd* v. *Alfred McAlpine Management Ltd* (1991) 56 Build LR 115, where the word in issue between the parties was 'standard'. Judge Stannard concluded (at p. 131) that:

[1] No wrong is done to one who consents.

> what is required for terms to be standard is that they should be so regarded by the party which advances them as its standard terms and that it should habitually contract in those terms. If it contracts also in other terms, it must be determined in any given case, and as a matter of fact, whether this has occurred so frequently that the terms in question cannot be regarded as standard, and if on any occasion a party has substantially modified its prepared terms, it is a question of fact whether those terms have been so altered that they must be regarded as not having been employed on that occasion.

The second case is *St Albans City and District Council* v. *International Computers Ltd* [1996] 4 All ER 481 where the word at stake was 'deals'. In that case counsel for the defendants submitted that 'you cannot be said to deal on another's standard terms of business if, as was the case here, you negotiate with him over those terms before you enter into the contract'. Nourse LJ rejected this submission. He stated (at p. 491):

> In my view that is an impossible construction for two reasons: first, because as a matter of plain English 'deals' means 'makes a deal', irrespective of any negotiations that may have preceded it; secondly, because s 12(1)(a) equates the expression 'deals as consumer' with 'makes the contract'. Thus it is clear that in order that one of the contracting parties may deal on the other's written standard terms of business within s.3(1) it is only necessary for him to enter into the contract on those terms.

On the other hand, where there has been meaningful negotiation about the terms of the contract which has resulted in alterations to the standard terms then it is much less likely that the requirements of section 3 will have been satisfied (see *The Flamar Pride* [1990] 1 Lloyd's Rep 434). This is particularly so if there is 'any significant difference between the terms proffered and the terms of the contract actually made' (*Yuanda (UK) Ltd* v. *WW Gear Construction Ltd* [2010] EWHC 720 (TCC), [2010] BLR 435, [26]).

The third case on section 3(1) is *British Fermentation Products Ltd* v. *Compair Reavell Ltd* [1999] BLR 352. This time the word in issue was 'other's'. The contract between the parties was concluded on the Institution of Mechanical Engineers Model Form of General Conditions of Contract. One of the issues between the parties was whether or not this Model Form of contract fell within the scope of section 3(1). Judge Bowsher QC concluded that it did not. He did not attempt to lay down any general principle as to when 'Model Forms drafted by an outside party' fall within the scope of section 3 but stated (at p. 361) that:

> if the Act ever does apply to such Model Forms, it does seem to me that one essential for the application of the Act to such forms would be proof that the Model Form is invariably or at least usually used by the party in question. It must be shown that either by practice or by express statement a contracting party has adopted a Model Form as his standard terms of business. For example, an architect might say, 'My standard terms of business are on the terms of the RIBA Form of Engagement'. Without such proof, it could not be said that the Form is, in the words of the Act, '*the other's*' standard terms of business. I leave open the question what would be the position where there is such proof, and whether such proof either alone or with other features would make section 3 of the Act applicable. [Emphasis in the original.]

On the facts of the case it had neither been alleged nor proved that the defendants either invariably or usually used the Model Form. Nor did the defendants state that they would only be prepared to contract on the Model Form; they may well have been prepared to contract

on other terms. In the absence of proof of the practice of the defendants, the vital question related to the burden of proof. Judge Bowsher QC stated that it was for the claimants to show that the Act applied and this they had not done. This being the case, the Model Form had not been shown to be the defendants' standard terms of business and section 3 did not apply to the contract between the parties.

One word in section 3(1) which has not, as yet, been litigated is 'written'. Does section 3 apply to a contract that is partly written and partly oral? The Scottish case of *McCrone* v. *Boots Farm Sales Ltd* 1981 SLT 103 is sometimes cited in support of the proposition that section 3 applies to such a contract. But *McCrone* was concerned with the interpretation of Part II of the Act and the wording of section 17 differs from the wording of section 3. Section 17 uses the phrase 'standard form contract'. The absence of the word 'written' from section 17 made it easy for Lord Dunpark to conclude that the section applied to contracts which are partly oral. It is much more difficult to reach this conclusion in relation to section 3 given the use of the word 'written'.

The second point to note in relation to section 3 is that section 3(2)(a) applies to clauses that seek to exclude or restrict liability for breach of contract. Such clauses are subject to the reasonableness test, on which see section 11 extracted later (pp. 432–438, later in this section).

The third point relates to the subject matter of section 3(2)(b). This is a much more difficult provision than section 3(2)(a). Given that the latter provision regulates attempts to exclude liability for breach of contract, the former must regulate something other than cases of breach because otherwise the two provisions overlap. So what is the subject matter of section 3(2)(b)? It applies in two cases. The first is where one party claims to be entitled to render a 'contractual performance substantially different from that which was reasonably expected of him' and the second is where he claims to be entitled to render 'no performance'. An example in the latter category might be the case where a defendant seeks to rely on a widely drafted force majeure clause (on which see pp. 397–398, Chapter 12, Section 3(e)) in order to justify his failure to perform his obligations under the contract. There is, as yet, no case on this issue and so the question whether section 3(2)(b)(ii) applies to force majeure clauses remains a matter of some doubt. In practice it may be that the issue will never be litigated because, even if the subsection is held to extend to force majeure clauses, the likelihood of such a clause passing the reasonableness test is high.

Section 3(2)(b) has been the subject of some judicial analysis. The leading case is the decision of the Court of Appeal in *Timeload Ltd* v. *British Telecommunications plc* [1995] EMLR 459. The plaintiffs sought an interlocutory injunction to restrain the defendants, BT, from terminating the contract between them under clause 18 of the contract which provided that BT had the right 'at any time' to terminate the contract between the parties on the giving of one month's notice. The reason why the plaintiffs wanted an injunction to prevent termination was that they wanted to keep their telephone number and termination of the contract would have deprived them of their ability to do so. The plaintiffs sought to challenge the validity of clause 18 under section 3 of the Act. The application was for an interlocutory injunction and so it was not necessary for the Court of Appeal to resolve definitively the scope of section 3(2)(b)(i). Sir Thomas Bingham MR set out the submission of counsel for BT, Mr Hobbs, and his response to that submission as follows (at p. 468):

> Mr Hobbs submits that the subsection cannot apply where, as here, the clause under consideration defines the service to be provided and does not purport to permit substandard or

> partial performance. He says that the customer cannot reasonably expect that which the contract does not purport to offer, namely enjoyment of a telephone service under a given number for an indefinite period. That may indeed be so, but I find the construction and ambit of this subsection by no means clear. If a customer reasonably expects a service to continue until BT has substantial reason to terminate it, it seems to me at least arguable that a clause purporting to authorise BT to terminate it without reason purports to permit partial or different performance from that which the customer expected. If, however, s 3(2) does not in its precise terms cover this case, I do not myself regard that as the end of the matter. As I ventured to observe in *Interfoto Picture Library Ltd* v. *Stiletto Visual Programmes Ltd* [1989] QB 433, 439, the law of England, while so far eschewing any broad principle of good faith in the field of contract, has responded to demonstrated problems of unfairness by developing a number of piecemeal solutions directed to the particular problem before it. It seems to me at least arguable that the common law could, if the letter of the statute does not apply, treat the clear intention of the legislature expressed in the statute as a platform for invalidating or restricting the operation of an oppressive clause in a situation of the present, very special, kind. I say no more than there is, I think, a question here which has attracted much attention in Commonwealth jurisdictions and on the continent and may well deserve to be further explored here.

This is an adventurous decision. But it has to be remembered that it is a decision on an interlocutory application and so cannot be regarded as the last word on the scope of the subsection.

A more conservative approach was adopted in *Peninsula Business Services Ltd* v. *Sweeney* [2004] IRLR 49. A term in a contract of employment stated that 'an employee has no claim whatsoever to any commission payments that would otherwise have been generated and paid if he is not in employment on the date when they would normally have been paid'. The claimant resigned his post with the defendants and, as a consequence, he had to forgo substantial commission payments to which he would have been entitled had he remained in employment. He challenged the decision to withhold commission on the ground that the clause purported to entitle his employers to render a contractual performance substantially different from that which was reasonably expected of them. His claim failed on the ground that the defendants were simply operating the contract in accordance with its terms so that section 3(2)(b) was not applicable on the facts. Rimer J stated that the clause 'simply defined the limits' of the claimant's rights and did not purport to 'cut down or restrict his rights in any way'. This reasoning is very different to that adopted by the Court of Appeal in *Timeload* and it is open to criticism on the basis that it appears to ignore the fact that the aim of the subsection is to extend the scope of the Act to certain duty-defining contract terms. Thus the fact that the term assisted in the definition of the claimant's rights should not, of itself, have had the effect of taking the term outside the scope of the subsection. A better ground for rejecting the claimant's reliance on section 3(2)(b) was that there was 'no basis on which [the claimant] could ever have reasonably expected any rights greater than' those that the contract conferred on him. On this basis it would appear that the distinction between *Peninsula* and *Timeload* lies principally in the weight given by the court to the terms of the contract when seeking to ascertain the reasonable expectations of the parties. It is suggested that the approach of the court in *Peninsula* is the preferable one and that a court ought to attach considerable weight to the terms of the contract when identifying the reasonable expectations of the parties unless it can be demonstrated that the party relying on the term of the contract either knew, or ought to have known, that the other party to the contract was unaware of the term of the contract and could not reasonably be expected to have been familiar with it.

The easier case to accommodate within the subsection is the case in which a service provider purports to be entitled to offer the customer an alternative performance that is of a lower standard than the service originally offered. Take the case of a holiday company which reserves the right to offer its customer an alternative holiday should the one which the customer originally booked turn out, for some reason, to be unavailable. In offering an alternative holiday the company is not in breach of contract because it has reserved the right to do so. But the customer may be able to challenge the validity of such a term under section 3(2)(b), at least where the clause purports to entitle the holiday company to offer a holiday of a lower standard than that originally offered (see *Axa Sun Life Services plc* v. *Campbell Martin Ltd* [2011] EWCA Civ 133, [2011] 2 Lloyd's Rep 1, [50]).

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.

Commentary

The subject matter of section 4 is indemnity clauses. An indemnity clause is a clause by which one party is obliged to pay a sum of money to the other in respect of a liability which that other party has incurred. Section 4 only applies where the party required to make the indemnity is a consumer. Take the case of a consumer who hires a car from a car hire company. The company may insert into its terms of business a term to the effect that the consumer must indemnify the car hire company in respect of any liability it may incur to a third party as a result of the consumer's use of the car. Such an indemnity is caught by section 4 and is subject to the requirement of reasonableness (on which see section 11, extracted later). Matters are otherwise where the car is hired out, not to a consumer, but to a business. In such a case the indemnity will not fall within the scope of section 4. Commercial indemnities are outside the scope of the section and, if they are regulated at all, they fall within the scope of section 2 (see *Phillips Products Ltd* v. *Hyland* [1987] 1 WLR 659 and *Thompson* v. *T Lohan (Plant Hire) Ltd* [1987] 1 WLR 649, discussed in more detail at pp. 449–456, Section 4).

Liability arising from sale or supply of goods

'Guarantee' of consumer goods

5.—(1) In the case of goods of a type ordinarily supplied for private use or consumption, where loss or damage—

(a) arises from the goods proving defective while in consumer use; and

(b) results from the negligence of a person concerned in the manufacture or distribution of the goods,

liability for the loss or damage cannot be excluded or restricted by reference to any contract term or notice contained in or operating by reference to a guarantee of the goods.

(2) For these purposes—

(a) goods are to be regarded as 'in consumer use' when a person is using them, or has them in his possession for use, otherwise than exclusively for the purposes of a business; and

(b) anything in writing is a guarantee if it contains or purports to contain some promise or assurance (however worded or presented) that defects will be made good by complete or partial replacement, or by repair, monetary compensation or otherwise.

(3) This section does not apply as between the parties to a contract under or in pursuance of which possession or ownership of the goods passed.

Commentary

This section deals with a rather different matter, namely the relationship between a manufacturer or a distributor of goods and a consumer. It provides that a manufacturer or distributor cannot by reference to the terms of a 'guarantee' exclude or restrict liability for loss or damage that arises from defects in the goods while they are 'in consumer use'. But it only does so where the loss or damage results from the negligence of a person concerned in the manufacture or distribution of the goods.

Liability arising from sale or supply of goods

Sale and hire-purchase

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

(a) section 12 of the Sale of Goods Act 1979 (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 1979 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.

Commentary

This section regulates attempts to exclude liability for breach of the implied terms in contracts for the sale of goods (sections 12–15 of the Sale of Goods Act 1979, on which see pp. 338–341, Chapter 10, Section 2) and contracts of hire-purchase (sections 8–12 of the Supply of Goods (Implied Terms) Act 1973). The fundamental distinction that has to be drawn is between the case where the buyer is, and the case where he is not, dealing as consumer. Where the buyer is dealing as consumer, liability for breach of the implied terms cannot be excluded but where the buyer is not dealing as consumer liability can be excluded provided that the term satisfies the requirement of reasonableness (except in the case of an attempt to exclude liability for a breach of section 12 of the Sale of Goods Act 1979 or section 8 of the Supply of Goods (Implied Terms) Act 1973, both of which are inevitably void). The phrase 'dealing as consumer' is defined in section 12 (p. 438, later in this section) and reasonableness is defined in section 11 (p. 432, later in this section). This section applies to any attempt to exclude or restrict liability for breach of one of the implied terms, even if the liability sought to be excluded is not a business liability within the meaning of section 1(3) of the 1977 Act (section 6(4)). This extension of the scope of the Act is not as big as it might at first sight appear because the 'satisfactory quality' and 'fitness for purpose' implied terms only operate where the seller sells the goods in the course of a business (see p. 342, Chapter 10, Section 2).

Miscellaneous contracts under which goods pass

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.

(3A) Liability for breach of the obligations arising under section 2 of the Supply of Goods and Services Act 1982 (implied terms about title, etc. in certain contracts for the transfer of the property in goods) cannot be excluded or restricted by reference to any such term.

(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,

(c) cannot (in a case to which subsection (3A) above does not apply) be excluded or restricted by reference to any such term except in so far as the term satisfies the requirement of reasonableness.

(5) This section does not apply in the case of goods passing on a redemption of trading stamps within the Trading Stamps Act 1964 or the Trading Stamps Act (Northern Ireland) 1965.

Commentary

This section performs a similar function to section 6 but it applies to contracts other than contracts for the sale of goods and contracts of hire-purchase under which possession or ownership of goods passes to another party. Thus it applies to contracts of hire, contracts for work and materials, and contracts of exchange. The distinction between the case where one party deals as consumer and the case where one party does not is once again of crucial significance because liability cannot be excluded as against a person who deals as consumer but the parties generally have greater liberty to exclude or restrict liability as against a person who does not deal as consumer. The requirement of reasonableness is discussed later in this section (pp. 432–438).

Effect of breach

9.—(1) Where for reliance upon it a contract term has to satisfy the requirement of reasonableness, it may be found to do so and be given effect accordingly notwithstanding that the contract has been terminated either by breach or by a party electing to treat it as repudiated.

(2) Where on a breach the contract is nevertheless affirmed by a party entitled to treat it as repudiated, this does not of itself exclude the requirement of reasonableness in relation to any contract term.

Commentary

This section confirms that the fact that the contract has been terminated does not, of itself, prevent a party from relying upon an exclusion or limitation clause contained in the contract. In this way it confirms the fact that the 'rule of law' version of fundamental breach (on which see p. 418, Section 2(b)) is not good law. Section 9(2) provides that affirmation of the contract (on which see p. 799, Chapter 22, Section 5) does not of itself exclude the requirement of reasonableness.

Evasion by means of secondary contract

10. A person is not bound by any contract term prejudicing or taking away rights of his which arise under, or in connection with the performance of, another contract, so far as those rights extend to the enforcement of another's liability which this Part of this Act prevents that other from excluding or restricting.

Commentary

This section gives rise to a number of interpretative difficulties. The effect of the section has been summed up in H Beale (ed), *Chitty on Contracts* (30th edn, Sweet & Maxwell, 2008), para 14–081 in the following terms:

> The purpose of this provision has been said to be to prevent rights arising in favour of A under a contract between A and B from being affected by the terms of a secondary contract between A and C which take away or inhibit the exercise of those rights, as, for example, where a term in a contract between a manufacturer of goods and the buyer purports to

affect the rights of the buyer under the Sale of Goods Act against the retailer from whom he purchases the goods. The scope of the section is, however, enigmatic. It employs the words 'prejudicing or taking away rights' instead of the usual 'excludes or restricts liability'. The extended interpretation of the latter phrase therefore does not apply. Also the reference to 'the enforcement of another's *liability*' would preclude the application of section 10 to a case where the terms of the secondary contract purported to entitle a party to another contract to render a performance substantially different from that reasonably expected of him, or to render no performance at all.

It has been held that the section does not apply to the compromise or waiver of an existing contractual claim (*Tudor Grange Holdings Ltd* v. *Citibank NA* [1992] Ch 53).

Explanatory provisions

The 'reasonableness' test

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.

Commentary

This section is one of the most important provisions in the Act. The reasonableness test applies to clauses that fall within the scope of sections 2(2), 3, 4, 6(3), 7(3), 7(4), and 8. It is therefore of wide application. A number of points can be made in relation to the scope of

this section. The first is that subsection (1) establishes that the time at which the reasonableness test is to be applied is the time of entry into the contract. It is not the time at which the breach of contract occurred. The aim of the reasonableness test is therefore to examine the reasonableness or the fairness of the allocation of the rights and responsibilities between the parties at the moment of entry into the contract.

The second point is that, in the case of contracts that fall within sections 6 and 7 of the Act, the court is expressly directed by subsection (2) to take into account the matters listed in Schedule 2 (p. 444, later in this section). However the significance of the factors listed in Schedule 2 transcends cases that fall within the scope of sections 6 and 7. In practice, the courts have regard to these factors even in cases that do not fall within the scope of sections 6 and 7.

The third point relates to the application of the reasonableness test to notices. It differs from the test applicable to contract terms. Subsection (3) provides that it must have been fair and reasonable to rely on the notice and that the court is to have regard to the circumstances obtaining when the liability arose or when, but for the notice, it would have arisen.

Subsection (4) requires the court to take into account two matters in the case of clauses that seek to limit rather than exclude liability. It does not follow that these matters are irrelevant in the case of total exclusions of liability; it is simply that they are particularly relevant in the context of limitation clauses, in the sense that the court must have regard to these factors. As we shall see (p. 436, later in this section), availability of insurance has proved to be an important factor in deciding whether or not a clause is reasonable.

Subsection (5) is an important provision because it puts the onus of proof in relation to reasonableness upon the party who asserts that the term or notice is reasonable. It is therefore unnecessary for a claimant to state in his statement of claim that he intends to challenge the reasonableness of a clause (*Sheffield* v. *Pickfords Ltd* [1997] CLC 648).

In deciding whether or not a particular clause is reasonable, the courts have regard to a range of factors. Judges have a considerable degree of discretion in the application of the reasonableness test to the facts of individual cases. The balancing of the different factors is left largely to the decision of the trial judge. The appellate courts have been extremely reluctant to review the findings of trial judges on the issue of whether a particular clause is or is not reasonable (see *George Mitchell (Chesterhall) Ltd* v. *Finney Lock Seeds Ltd* [1983] 2 AC 803, p. 445, Section 4, and *Cleaver* v. *Schyde Investments Ltd* [2011] EWCA Civ 929, [2011] All ER (D) 285 (Jul)), unless the judge has had regard to some factor which was irrelevant or has adopted an interpretation of the exclusion clause which is incorrect (see, for example, *Watford Electronics Ltd* v. *Sanderson CFL Ltd* [2001] All ER (Comm) 696).

When deciding whether or not the requirement of reasonableness has been satisfied, the courts have had regard to factors such as the following:

(i) **The meaning of the clause.** This is clearly a very important factor. In *Watford Electronics Ltd* v. *Sanderson CFL Ltd* [2001] All ER (Comm) 696 the Court of Appeal emphasized the need to ascertain the meaning of a clause before deciding whether or not it satisfies the requirement of reasonableness. The clause in dispute in *Watford Electronics* was clause 7.3 which provided:

> Neither the Company nor the Customer shall be liable to the other for any claims for indirect or consequential losses whether arising from negligence or otherwise. In no event shall the Company's liability under the Contract exceed the price paid by the Customer to the Company for the Equipment connected with any claim.

The Court of Appeal held that it was necessary to ascertain the meaning of this clause before applying the reasonableness test to it. Chadwick LJ stated (at [35]):

> In order to decide whether the relevant contract term was 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 it is necessary, as it seems to me, to determine, first, the scope and effect of that term as a matter of construction. In particular, it is necessary to identify the nature of the liability which the term is seeking to exclude or restrict. Whether or not a contract term satisfies the requirement of reasonableness within the meaning of section 11 of the Unfair Contract Terms Act 1977 does not fall to be determined in isolation. It falls to be determined where a person is seeking to rely upon the term in order to exclude or restrict his liability in some context to which the earlier provisions of the 1977 Act (or the provisions of section 3 of the Misrepresentation Act 1967) apply.

When ascertaining the meaning of clause 7.3 the Court of Appeal broke it down into its two sentences. It held that the purpose of the first sentence was to exclude contractual claims for indirect and consequential losses: that is to say to exclude liability in contract for cases which fall within the second limb of the rule in *Hadley* v. *Baxendale* (1854) 9 Exch 341 (on the meaning of 'indirect or consequential loss' see pp. 419–421, Section 2(d)). Contrary to the view taken by the trial judge, Judge Thornton QC, it was held that the first sentence did not purport to exclude claims in respect of pre-contractual misrepresentations (this point is discussed in more detail at pp. 623–624, Chapter 17, Section 6). The purpose of the second sentence of clause 7.3 was held to be to restrict the seller's liability under the contract with the customer to a specified sum of money, namely the price paid by the customer for the equipment. The meaning of the clause has an obvious bearing on the likelihood of it passing the reasonableness test. The wider the scope of the clause, the less likelihood there may be that it will pass the reasonableness test. Conversely, the narrower its scope, the more likely it may be to pass the test (*Regus (UK) Ltd* v. *Epcot Solutions Ltd* [2008] EWCA Civ 361, [2009] 1 All ER (Comm) 586).

(ii) **Equality of bargaining power**. The greater the equality of the bargaining power of the parties, the more likely it is that the clause will pass the reasonableness test. The Court of Appeal in *Watford Electronics Ltd* v. *Sanderson CFL Ltd* (Section (i)) took a particularly robust line in this respect. Chadwick LJ stated (at [55]):

> 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.

In so far as this statement suggests there must be some form of 'advantage taking' or a failure to comprehend the clause before courts will intervene to declare exclusion or limitation clauses unreasonable in contracts between 'experienced businessmen representing

substantial companies of equal bargaining power' it goes too far. But it would be fair to say that the weight of judicial opinion demonstrates a marked reluctance to invalidate a clause which has been agreed between two substantial commercial parties who have access to legal advice (see, for example, *Granville Oil & Chemicals* v. *Davis Turner* [2003] EWCA Civ 570, [2003] 2 Lloyd's Rep 356, [31] and *Raiffeisen Zentralbank Osterreich AG* v. *Royal Bank of Scotland plc* [2010] EWHC 1392 (Comm), [2011] 1 Lloyd's Rep 123, [321]). Although cases can be found in which the courts have not attached such weight to the ability of businessmen to look after themselves in the market place (see, for example, *Britvic Soft Drinks Ltd* v. *Messer UK Ltd* [2002] 1 Lloyd's Rep 20, 57–58 and *George Mitchell (Chesterhall) Ltd* v. *Finney Lock Seeds Ltd* [1983] 2 AC 803 (p. 445, Section 4), these are very much the minority. Even in the case where the party challenging the validity of the clause is a 'small business' little emphasis may be given to this factor, especially if it is 'an experienced commercial enterprise'. As Moore-Bick LJ observed in *Rohlig (UK) Ltd* v. *Rock Unique Ltd* [2011] EWCA Civ 18, [2011] 2 All ER (Comm) 1161, [16], 'the relative sizes in corporate terms of the parties to the contract is unlikely to be a significant factor in cases of this kind where a small but commercially experienced organisation contracts to obtain services of a kind that are available from a large number of competing suppliers.'

(iii) **Regard must be had to the clause as a whole**. The clause must be tested at the moment of entry into the contract, not the moment of breach. This being the case, the court cannot simply have regard to that part of the clause that is in issue between the parties on the facts as they have turned out. It must have regard to the clause in its entirety and the range of events to which the clause could realistically apply and decide whether or not it is reasonable. This has important implications for the drafting of an exclusion or limitation clause. There is a temptation to draft the clause as widely as possible in order to protect the client to the greatest extent possible. This is a temptation which, in general, should be resisted. The reason for this is that the validity of the clause can be tested at its weakest point. Suppose that in a contract for the sale of goods a clause states that a buyer can only reject goods if he does so within seven days of the date of purchase and all other implied conditions in the Sale of Goods Act are excluded. Such a clause may be entirely reasonable in relation to a patent defect but it is probably unreasonable in relation to a latent defect. A commercial buyer faced by such a clause can challenge it on the ground that it is unreasonable in its application to latent defects. It should not matter that the actual defect in the goods was patent because the validity of the clause is to be tested at the time of entry into the contract (when the nature of the defect will be unknown) not the date of breach.

A further factor which suggests the need for caution is that the courts have held that they do not have the power to sever the unreasonable parts of an exclusion clause so as to render the clause reasonable (see *Stewart Gill Ltd* v. *Horatio Myer & Co Ltd* [1992] QB 600). It can be argued that the courts should in fact have this power because of the presence of the words 'in so far as' in, for example, sections 2(2) and 3(2) (pp. 423 and 424, earlier in this section). These words might be thought to suggest that, to the extent that the clause is reasonable, effect should be given to it. But the courts have thus far declined to embark upon the modification of clauses with a view to saving as much of the clause as possible. The clause will generally either stand or fall; it will not be re-written by the courts. This has important consequences for the drafting of limitation clauses. A limitation clause that is unreasonable because it is too low is ineffective to place any limit on the liability of the party in breach. The court cannot insert into the limitation clause a sum which it believes to be fair and reasonable. This being the case, a limitation clause should always be set at a realistic level because

the consequences of it being held to be unreasonable as a result of it being set too low may be disastrous.

Given that the courts declare that they have no general power to separate out the unreasonable parts of an exclusion clause from the reasonable parts, draftsmen frequently carry out the task themselves and separate out an exclusion clause into different constituent parts in the hope that, if one part is held to be invalid, its invalidity will not spread throughout the clause. There are signs that the courts will respect this drafting device and not spread the infection. For example in *Watford Electronics Ltd* v. *Sanderson CFL Ltd* the Court of Appeal considered the two sentences in clause 7.3 separately when seeking to ascertain the meaning of the clause and the reasonableness test should also be separately applied to each sentence. This being the case, any invalidity in the first sentence should not necessarily result in the second sentence being held to be invalid (see to similar effect *Regus (UK) Ltd* v. *Epcot Solutions Ltd* [2008] EWCA Civ 361, [2009] 1 All ER (Comm) 586).

(iv) **The importance of insurance**. The court will have regard to the availability of insurance but not to the actual insurance position of the parties (see *The Flamar Pride* [1990] 1 Lloyd's Rep 434). It is expressly directed to take account of the availability of insurance in relation to limitation clauses (see section 11(4)). In *Moores* v. *Yakeley Associates Ltd* (1999) 62 Con LR 76 the defendant agreed to provide architectural services for the plaintiff. The defendant limited his liability to £250,000. The defendant, a one-man company, had taken out insurance cover of £500,000. When asked why he had not chosen £500,000 as the limitation figure, Mr Yakeley responded that (i) he considered the figure of £250,000 to be reasonable having regard to the estimated cost of the project (between £225,000 and £274,000) and (ii) he was concerned to leave some allowance in case he had to meet any legal costs. Dyson J accepted the first of these explanations and did not consider the second. But, given that it is the availability of insurance that matters, the fact that the defendant was actually insured for a sum in excess of the sum stipulated in the limitation clause should not suffice, of itself, to establish that the limitation was an unreasonable one.

(v) **The dangers of relaxation of the clause in practice**. A party to a contract may have good commercial reasons for not wishing to enforce an exclusion or limitation clause against a customer, particularly a well-established customer. The fear of losing business may lead it not to enforce the clause according to its letter. But such conduct may lead a court to conclude that the term is unreasonable. Non-enforcement of the clause was 'the decisive factor' that led the House of Lords in *George Mitchell (Chesterhall) Ltd* v. *Finney Lock Seeds Ltd* [1983] 2 AC 803 (p. 445, Section 4) to conclude that the term was unreasonable. In other cases the courts have taken a more relaxed view. In *Schenkers Ltd* v. *Overland Shoes Ltd* [1998] 1 Lloyd's Rep 498 Pill LJ stated (at p. 508):

> In present circumstances, I see little merit in the defendants' argument that the clause had not in practice been relied upon. The give and take practised by the parties in the course of substantial dealings upon the running account was admirable and conducive to a good business relationship but did not in my judgment prevent the plaintiffs, when the dispute arose, relying upon the term agreed. In *George Mitchell*, there was evidence that neither party expected the limitation of liability clause to [be] applied literally and a recognition that reliance on the clause was unreasonable. While there was evidence in the present case that there was no ready or frequent resort to the clause, there was no such recognition. I cannot find conduct which permits the defendants to claim that reliance on the clause would be unfair or unreasonable.

This suggests that it is important to examine the reason for the non-enforcement of a particular clause. If it is attributable to the 'give and take' of business life it will do little in terms of establishing the unreasonableness of the clause. But where the reason for the non-enforcement of the clause is general recognition of the fact that the clause does not operate reasonably it will provide very good evidence from which a court can infer that the clause is unreasonable (as in the *George Mitchell* case where Lord Bridge regarded this as the 'decisive factor'—see p. 448, Section 4).

(vi) **Two different losses within the same clause**. It is not generally advisable to include two very different types of loss within the same limitation clause. In *Overseas Medical Supplies Ltd* v. *Orient Transport Services Ltd* [1999] 2 Lloyd's Rep 273 the defendant freight forwarders failed to insure the plaintiffs' goods as they were required to do under the terms of the contract. The defendants limited their liability, both for any damage suffered during transit and in respect of their failure to take out insurance, to £600. The trial judge held that a limitation of £600 would have been reasonable for a claim for direct loss suffered by the plaintiffs while the goods were in transit, but it was not reasonable for a failure to insure. He therefore held that the clause was unreasonable and the Court of Appeal affirmed his decision. The two losses subject to the £600 limitation were very different in nature. Had the goods been damaged in transit the defendants' liability would have been limited to £600 but the plaintiffs would have been able to look to their insurers for the rest of their loss. But in the case of a failure to insure there was no one else to whom the plaintiffs could look in relation to the loss in excess of £600. Potter LJ stated (at p. 280):

> The burden of proof of reasonableness was upon the [defendants] in the case. Their position was that of a trading organisation which, under a single contract had agreed to combine at least two activities or functions in respect of which the nature of the work undertaken, the incidence of risk as between the parties, and the effect of a breach of duty by the [defendants] were all of different character, yet were treated without distinction as subject to a single limitation of liability of only £600. Whereas it may be that, in relation to certain 'package' services, a broad brush approach to limitation of liability will be reasonable, and indeed may largely be dictated by the type of insurance cover available in the market to the supplier, the Judge held that, in this case, such an approach was unjust and inappropriate for reasons which he clearly and comprehensively stated.
>
> In my view, the judgment of Judge Kenny was a careful one in which he considered and weighed the various considerations in a manner which is not open to any substantial criticism.

(vii) **The advantage of limitation clauses**. In many cases a sensibly drawn limitation clause is more likely to pass the reasonableness test than a total exclusion of liability. This proposition was thrown into some doubt by the decision of the Court of Appeal in *St Albans City and District Council* v. *International Computers Ltd* [1996] 4 All ER 481 where it was held that a limitation clause of £100,000 in a contract to supply a computer system to a local authority was unreasonable. The case generated a considerable amount of concern in commercial practice but its impact has not proved to be great. Indeed, there is very little discussion of the reasonableness of the clause in the judgments of the Court of Appeal. The judges were content to conclude (at p. 492) that the trial judge had not 'proceeded upon some erroneous principle or was plainly and obviously wrong'. In reaching his conclusion that £100,000 was unreasonable on the facts of the case the trial judge, Scott Baker J, attached importance to the facts that the parties were of unequal bargaining power (the plaintiffs

being a local authority), the defendants had not justified the figure which they had inserted into the contract, and the defendants were insured and to the view that the party who stood to make the profit (here the defendants) should also take the risk. The conclusion of Scott Baker J is perhaps questionable but it was not, in the opinion of the Court of Appeal, 'plainly and obviously wrong'.

Other cases can be found in which limitation clauses have failed the reasonableness test (most notably *George Mitchell (Chesterhall) Ltd* v. *Finney Lock Seeds Ltd* [1983] 2 AC 803, p. 445, Section 4) but it remains the case that they are likely to pass the reasonableness test provided that the figure chosen is a realistic one (see, for example, *Britvic Soft Drinks Ltd* v. *Messer UK Ltd* [2002] 1 Lloyd's Rep 20 and *Shepherd Homes Ltd* v. *Encia Remediation Ltd* [2007] EWHC 70 (TCC), [2007] BLR 135). The onus of proof of showing that the clause is reasonable lies on the party relying upon the limitation clause. This being the case, that party must be able to lead evidence to show why it was that this particular figure was chosen as the limit of liability. A figure that is simply plucked out of the air will struggle to pass the reasonableness test. But a figure that is supported by some objective justification, such as the turnover of the party relying on the clause, the insurance cover available, or the value of the contract, will provide good evidence from which a court can infer that the clause was in fact reasonable.

These factors do not purport to be exhaustive. Other factors are listed in Schedule 2 to the Act (p. 444, later in this section). The task of the court in any given case is first to identify the factors to be taken into account when deciding whether or not the clause is reasonable and it must then balance these factors in a sensible fashion. A judge who carries out both of these tasks is unlikely to be overturned by the Court of Appeal, should an appeal be lodged against his decision.

'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.

(1A) But if the first party mentioned in subsection (1) is an individual paragraph (c) of that subsection must be ignored.

(2) But the buyer is not in any circumstances to be regarded as dealing as consumer—

(a) if he is an individual and the goods are second hand goods sold at public auction at which individuals have the opportunity of attending the sale in person;

(b) if he is not an individual and the goods are sold by auction or by competitive tender.

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

Commentary

Two requirements must be satisfied before a person can 'deal as consumer' within the meaning of this section. First, the person who asserts that he is dealing as a consumer must not

make the contract in the course of a business, nor hold himself out as doing so. Secondly, the other party to the contract must make the contract in the course of a business. It therefore follows that a contract between two parties, neither of whom is acting in the course of a business, does not constitute a 'consumer' contract for the purposes of the Act. When, for this purpose, is a contract made 'in the course of a business'? In *R & B Customs Brokers Co* v. *United Dominions Trust Ltd* [1988] 1 WLR 321 the plaintiff, a private company, purchased a car from the defendant finance company. The car had been supplied by a third party dealer. The car was bought for the personal and business use of one of the plaintiff's directors. The plaintiff rejected the car after discovering that the roof of the car leaked and the dealer had failed to rectify the problem. The terms of the contract between the defendant and the plaintiff purported to exclude any implied condition as to the condition or quality of the car or its fitness for any particular purpose. The plaintiff submitted that the exclusion was invalidated by section 6(2) of the 1977 Act (p. 429, earlier in this section) on the basis that it was dealing as consumer in entering into the contract to purchase the car. The Court of Appeal held that the plaintiff company was dealing as consumer with the result that the implied term could not be excluded. In reaching this conclusion the Court of Appeal adopted a rather narrow construction of 'in the course of a business'. It held that, in order to be 'in the course of a business', the transaction must either be integral to the business or, if not integral, must be entered into as part of the regular course of dealing of the business. On the facts the purchase of a car was not integral to the plaintiff's business. Nor was the contract entered into as a regular part of the business of the company. While the plaintiff had acquired two or three vehicles on credit terms this was held to be insufficient to establish the requisite degree of regularity. The conclusion that the plaintiff company dealt as a consumer is not one that could have been reached under the Unfair Terms in Consumer Contracts Regulations 1999 (see p. 462, Chapter 14, Section 2) because a company cannot be a consumer under the Regulations. The result in *R & B Customs* is, in many ways, a surprising one (but it was followed by the Court of Appeal in *Feldaroll Foundry Plc* v. *Hermes Leasing (London) Ltd* [2004] EWCA Civ 747). The effect of the decision was to deprive the defendants of any opportunity to prove that their exclusion clause was reasonable because the effect of concluding that the plaintiff was dealing as consumer was to render the exclusion clause void. This seems a rather generous degree of protection for small businesses and the case has been the subject of a considerable degree of criticism (note also the much broader interpretation given to 'in the course of a business' by the Court of Appeal in *Stevenson* v. *Rogers* [1999] QB 1028 (p. 342, Chapter 10, Section 2) in the context of section 14(2) of the Sale of Goods Act 1979).

Varieties of exemption clause

13.—(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.

Commentary

Section 13 is another section which seeks to regulate attempts to evade the clutches of the Act. Subsection (1)(a) can catch a clause which puts a very short time-limit on the availability of a particular remedy or any remedy; subsection (1)(b) might catch a clause which excludes or restricts a right of set-off; and subsection (1)(c) would potentially catch a conclusive evidence clause (a clause which states that acceptance of the goods shall constitute conclusive evidence that the goods conform with the requirements of the contract). These extensions of the scope of the Act are useful in so far as they reduce the possibility of evasion by well-advised commercial parties. It is important to note that section 13 does not have an independent role; that is to say section 13 cannot be used to invalidate a particular clause. The function of section 13 is to extend the scope of sections 2 and 5–7 and it is to these sections that a court ought to look for jurisdiction to invalidate a clause. Section 13 cannot be used to extend the scope of section 3 but it is probably unnecessary to expand the scope of that section given the width of section 3(2)(b) (p. 426, earlier in this section).

Section 13(1) does, however, give rise to one very considerable interpretative difficulty. It relates to the meaning of the words 'terms and notices which exclude or restrict the relevant obligation or duty' at the end of the subsection. The effect of the addition of these words is to extend the scope of sections 2 and 5–7 of the Act beyond clauses which exclude or restrict a liability to clauses that define the relevant 'obligation or duty'. The problem is that all terms of a contract have a role to play in defining the obligations of the parties. Once the step is taken of recognizing that some duty-defining clauses fall within the scope of the Act, how can the courts decide which duty-defining clauses fall within the scope of the Act and which do not? The difficulties involved in this extension of the Act are neatly noted in the following passage from H Beale (ed), *Chitty on Contracts* (30th edn, Sweet & Maxwell, 2008), para 14–063):

> It may be difficult, however, to differentiate between contractual provisions which exclude or restrict the relevant obligation or duty, and those which define the scope of the obligation or which specify the duties of the parties. For example, a seller of kitchen utensils may expressly state that they are suitable to be used only on electric cookers and not with gas, or a surveyor may stipulate that he undertakes to carry out a valuation of the property and not a full structural survey. Further, there may be difficulty in distinguishing between provisions which exclude or restrict the relevant obligation or duty, and those which prevent it from arising, such as a clause limiting the ostensible authority of an agent to give undertakings or an 'entire agreement' clause.

We shall return to this issue, and the scope of section 13, when examining the decision of the Court of Appeal in *Phillips Products Ltd* v. *Hyland* [1987] 1 WLR 659 (p. 449, Section 4).

Interpretation of Part I

14. In this Part of this Act—

'business' includes a profession and the activities of any government department or local or public authority;

'goods' has the same meaning as in the Sale of Goods Act 1979;

'hire-purchase agreement' has the same meaning as in the Consumer Credit Act 1974;

'negligence' has the meaning given by section 1(1);

'notice' includes an announcement, whether or not in writing, and any other communication or pretended communication; and

'personal injury' includes any disease and any impairment of physical or mental condition.

Commentary

This section provides a number of important definitions. Particularly important are the definitions of 'business' and 'personal injury'. It should be noted that the definition of business does not purport to be exhaustive. A business need not necessarily be carried on with a view to making a profit.

PART III

Provisions Applying to the Whole of United Kingdom

Miscellaneous

International supply contracts

26.—(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.

Commentary

Section 26 of the Act provides that the limits imposed by the Act on the extent to which a person may exclude or restrict liability by reference to a contract term (whether for breach of contract or for misrepresentation) do not apply to liability arising under an international supply contract, nor are the terms of such a contract subject to the reasonableness

requirement under section 3 or 4. Given the volume of cross-border transactions that are concluded in the modern economy this is a very important provision. An international supply contract is defined in section 26(3) and (4). The phrase 'made by parties' is a reference to the principals to the contract in question and not to the agents (*Ocean Chemical Transport Inc* v. *Exnor Craggs Ltd* [2000] 1 Lloyd's Rep 446, 453). Section 26(4)(a) has been held to be directed to any case in which the parties contemplate at the time of entering into the contract that the contractual goods will be transported across national boundaries in order to achieve the commercial purpose of the contract, whether or not that transportation was necessary in order to fulfil the terms of the contract. Thus a contract will fall within this subsection where a person who carries on business abroad hires equipment from a supplier in this country in circumstances where both parties know that the intention is to use the goods abroad (*Trident Turboprop (Dublin) Ltd* v. *First Flight Couriers Ltd* [2009] EWCA Civ 290, [2010] QB 86). The requirement in section 26(4)(c) that the contract must provide for the goods to be delivered to the territory of a State other than that within whose territory those acts were done has been strictly interpreted. In particular, it is not enough to show that the goods have been delivered 'in' the territory of a State other than the State within whose territory the acts constituting the offer and acceptance were done. The goods must be delivered 'to' that country; in other words, the goods must have been delivered from a country which was outside of that territory (*Amiri Flight Authority* v. *BAE Systems plc* [2003] EWCA Civ 1447, [2004] 1 All ER (Comm) 385).

Choice of law clauses

27.—(1) Where the law applicable to a contract is the law of any part of the United Kingdom only by choice of the parties (and apart from that choice would be the law of some country outside the United Kingdom) sections 2 to 7 and 16 to 21 of this Act do not operate as part of the law applicable to the contract.

(2) This Act has effect notwithstanding any contract term which applies or purports to apply the law of some country outside the United Kingdom, where (either or both)—

(a) the term appears to the court, or arbitrator or arbiter to have been imposed wholly or mainly for the purpose of enabling the party imposing it to evade the operation of this Act; or

(b) in the making of the contract one of the parties dealt as consumer, and he was then habitually resident in the United Kingdom, and the essential steps necessary for the making of the contract were taken there, whether by him or by others on his behalf.

Commentary

Section 27(1) of the Act states that where the law applicable to a contract is the law of any part of the United Kingdom only by the choice of the parties, sections 2–7 of the Act do not operate as part of the law applicable to the contract. Thus foreign parties who choose English law as the law applicable to the contract do not thereby subject themselves to sections 2–7. Section 27(2) seeks to prevent evasion of the Act by resort to a choice of foreign law. Essentially, the controls contained in the Act cannot be evaded by the choice of a law outside the United Kingdom as the governing law if it appears that the choice of law was imposed wholly or mainly to enable the party imposing it to evade the operation of the Act or where one of the parties dealt as a consumer, was then habitually resident in the United Kingdom,

and the essential steps for the making of the contract were taken in the United Kingdom. This is an important provision in terms of consumer protection.

Saving for other relevant legislation

29.—(1) Nothing in this Act removes or restricts the effect of, or prevents reliance upon, any contractual provision which—

(a) is authorised or required by the express terms or necessary implication of an enactment; or

(b) being made with a view to compliance with an international agreement to which the United Kingdom is a party, does not operate more restrictively than is contemplated by the agreement.

(2) A contract term is to be taken—

(a) for the purposes of Part I of this Act, as satisfying the requirement of reasonableness; and

(b) for those of Part II, to have been fair and reasonable to incorporate,

if it is incorporated or approved by, or incorporated pursuant to a decision or ruling of, a competent authority acting in the exercise of any statutory jurisdiction or function and is not a term in a contract to which the competent authority is itself a party.

(5) In this section—

'competent authority' means any court, arbitrator or arbiter, government department or public authority;

'enactment' means any legislation (including subordinate legislation) of the United Kingdom or Northern Ireland and any instrument having effect by virtue of such legislation; and 'statutory' means conferred by an enactment.

Commentary

The Act does not purport to regulate any contractual provision which is authorized or required by the express terms or necessary implication of an enactment, nor any contractual provision which is necessary in order to secure compliance with an international agreement to which the United Kingdom is a party (section 29(1)). Relevant statutes and international conventions include those relating to carriage of goods by sea and carriage of passengers, goods, and luggage by air and by land. Furthermore, a contract term will be assumed to have satisfied the requirement of reasonableness if it is incorporated or approved by, or incorporated pursuant to a decision or ruling of, a competent authority (that is, any court, arbitrator, or arbiter, government department or public authority) acting in the exercise of any statutory jurisdiction or function and is not a term in a contract to which the competent authority is itself a party.

SCHEDULE 1

SCOPE OF SECTIONS 2 TO 4 AND 7

1. Sections 2 to 4 of this Act do not extend to—

(a) any contract of insurance (including a contract to pay an annuity on human life);

(b) any contract so far as it relates to the creation or transfer of an interest in land, or to the termination of such an interest, whether by extinction, merger, surrender, forfeiture or otherwise;

(c) any contract so far as it relates to the creation or transfer of a right or interest in any patent, trade mark, copyright or design right registered design, technical or commercial information or other intellectual property, or relates to the termination of any such right or interest;

(d) any contract so far as it relates—

(i) to the formation or dissolution of a company (which means any body corporate or unincorporated association and includes a partnership), or

(ii) to its constitution or the rights or obligations of its corporators or members;

(e) any contract so far as it relates to the creation or transfer of securities or of any right or interest in securities.

2. Section 2(1) extends to—

(a) any contract of marine salvage or towage;

(b) any charterparty of a ship or hovercraft; and

(c) any contract for the carriage of goods by ship or hovercraft;

but subject to this sections 2 to 4 and 7 do not extend to any such contract except in favour of a person dealing as consumer.

3. Where goods are carried by ship or hovercraft in pursuance of a contract which either—

(a) specifies that as the means of carriage over part of the journey to be covered, or

(b) makes no provision as to the means of carriage and does not exclude that means,

then sections 2(2), 3 and 4 do not, except in favour of a person dealing as consumer, extend to the contract as it operates for and in relation to the carriage of the goods by that means.

4. Section 2(1) and (2) do not extend to a contract of employment, except in favour of the employee.

5. Section 2(1) does not affect the validity of any discharge and indemnity given by a person, on or in connection with an award to him of compensation for pneumoconiosis attributable to employment in the coal industry, in respect of any further claim arising from his contracting that disease.

Commentary

Schedule 1 to the Act exempts a number of different types of contract from the controls contained in sections 2–4 of the Act. In particular, it should be noted that these sections do not apply to (i) any insurance contract, (ii) any contract so far as it relates to the creation or transfer of an interest in land, or the termination of such an interest, and (iii) any contract so far as it relates to the creation or transfer of a right or interest in any patent, trade mark, copyright, registered design, or any other intellectual property. It should also be noted that section 2(1) and (2) do not extend to contracts of employment, except in favour of the employee.

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.

Commentary

While a court is expressly directed to have regard to these factors where the validity of the clause is challenged under sections 6 and 7 of the Act, the influence of these factors is not confined to these contracts. The courts have regard to them in all cases where it is appropriate to do so.

4. TWO ILLUSTRATIVE CASES

George Mitchell (Chesterhall) Ltd v. Finney Lock Seeds Ltd
[1983] 2 AC 803, House of Lords

The facts are set out in the speech of Lord Bridge.

Lord Bridge of Harwich

My Lords, the appellants are seed merchants. The respondents are farmers in East Lothian. In December 1973 the respondents ordered from the appellants 301b. of Dutch winter white cabbage seeds. The seeds supplied were invoiced as 'Finney's Late Dutch Special'. The price was £201.60. 'Finney's Late Dutch Special' was the variety required by the respondents. It is a Dutch winter white cabbage which grows particularly well in the area of East Lothian where the respondents farm, and can be harvested and sold at a favourable price in the spring. The respondents planted some 63 acres of their land with seedlings grown from the seeds supplied by the appellants to produce their cabbage crop for the spring of 1975. In the event, the crop proved to be worthless and had to be ploughed in. This was for two reasons. First, the seeds supplied were not 'Finney's Late Dutch Special' or any other variety of Dutch winter white cabbage, but a variety of autumn cabbage. Secondly, even as autumn cabbage the seeds were of very inferior quality.

The issues in the appeal arise from three sentences in the conditions of sale endorsed on the appellants' invoice and admittedly embodied in the terms on which the appellants

contracted. For ease of reference it will be convenient to number the sentences. Omitting immaterial words they read as follows:

'1. In the event of any seeds or plants sold or agreed to be sold by us not complying with the express terms of the contract of sale . . . or any seeds or plants proving defective in varietal purity we will, at our option, replace the defective seeds or plants, free of charge to the buyer or will refund all payments made to us by the buyer in respect of the defective seeds or plants and this shall be the limit of our obligation.

2. We hereby exclude all liability for any loss or damage arising from the use of any seeds or plants supplied by us and for any consequential loss or damage arising out of such use or any failure in the performance of or any defect in any seeds or plants supplied by us or for any other loss or damage whatsoever save for, at our option, liability for any such replacement or refund as aforesaid.

3. In accordance with the established custom of the seed trade any express or implied condition, statement or warranty, statutory or otherwise, not stated in these conditions is hereby excluded.'

I will refer to the whole as 'the relevant condition' and to the parts as 'clauses 1, 2 and 3' of the relevant condition.

The first issue is whether the relevant condition, on its true construction in the context of the contract as a whole, is effective to limit the appellants' liability to a refund of £201.60, the price of the seeds ('the common law issue'). The second issue is whether, if the common law issue is decided in the appellants' favour, they should nevertheless be precluded from reliance on this limitation of liability pursuant to the provisions of the modified section 55 of the Sale of Goods Act 1979 which is set out in paragraph 11 of Schedule 1 to the Act and which applies to contracts made between May 18, 1973, and February 1, 1978 ('the statutory issue').

[He first dealt with 'the common law issue' and concluded that 'the relevant condition' was effective, as a matter of construction, to limit the appellants' liability to the replacement of the seeds or the refund of the price paid. He then turned to 'the statutory issue'.]

The statutory issue turns, as already indicated, on the application of the provisions of the modified section 55 of the Sale of Goods Act 1979, as set out in paragraph 11 of Schedule 1 to the Act . . .

'(4) In the case of a contract of sale of goods, any term of that or any other contract exempting from all or any of the provisions of section 13, 14 or 15 above is void in the case of a consumer sale and is, in any other case, not enforceable to the extent that it is shown that it would not be fair or reasonable to allow reliance on the term.

(5) In determining for the purposes of subsection (4) above whether or not reliance on any such term would be fair or reasonable regard shall be had to all the circumstances of the case and in particular to the following matters—(a) the strength of the bargaining positions of the seller and buyer relative to each other, taking into account, among other things, the availability of suitable alternative products and sources of supply; (b) whether the buyer received an inducement to agree to the term or in accepting it had an opportunity of buying the goods or suitable alternatives without it from any source of supply; (c) whether the buyer 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 exempts from all or any of the provisions of section 13, 14, or 15 above 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 buyer . . . '

The statutory issue . . . turns on the words in subsection (4) 'to the extent that it is shown that it would not be fair or reasonable to allow reliance on' this restriction of the appellants' liabilities, having regard to the matters referred to in subsection (5).

This is the first time your Lordships' House has had to consider a modern statutory provision giving the court power to override contractual terms excluding or restricting liability, which depends on the court's view of what is 'fair and reasonable'. The particular provision of the modified section 55 of the Act of 1979 which applies in the instant case is of limited and diminishing importance. But the several provisions of the Unfair Contract Terms Act 1977 which depend on 'the requirement of reasonableness', defined in section 11 by reference to what is 'fair and reasonable', albeit in a different context, are likely to come before the courts with increasing frequency. It may, therefore, be appropriate to consider how an original decision as to what is 'fair and reasonable' made in the application of any of these provisions should be approached by an appellate court. It would not be accurate to describe such a decision as an exercise of discretion. But a decision under any of the provisions referred to will have this in common with the exercise of a discretion, that, in having regard to the various matters to which the modified section 55(5) of the Act of 1979, or section 11 of the Act of 1977 direct attention, the court must entertain a whole range of considerations, put them in the scales on one side or the other, and decide at the end of the day on which side the balance comes down. There will sometimes be room for a legitimate difference of judicial 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, in my view, 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.

Turning back to the modified section 55 of the Act of 1979, it is common ground that the onus was on the respondents to show that it would not be fair or reasonable to allow the appellants to rely on the relevant condition as limiting their liability. It was argued for the appellants that the court must have regard to the circumstances as at the date of the contract, not after the breach. The basis of the argument was that this was the effect of section 11 of the Act of 1977 and that it would be wrong to construe the modified section 55 of the Act as having a different effect. Assuming the premise is correct, the conclusion does not follow. The provisions of the Act of 1977 cannot be considered in construing the prior enactment now embodied in the modified section 55 of the Act of 1979. But, in any event, the language of subsections (4) and (5) of that section is clear and unambiguous. The question whether it is fair or reasonable to allow reliance on a term excluding or limiting liability for a breach of contract can only arise after the breach. The nature of the breach and the circumstances in which it occurred cannot possibly be excluded from 'all the circumstances of the case' to which regard must be had.

The only other question of construction debated in the course of the argument was the meaning to be attached to the words 'to the extent that' in subsection (4) and, in particular, whether they permit the court to hold that it would be fair and reasonable to allow partial reliance on a limitation clause and, for example, to decide in the instant case that the respondents should recover, say, half their consequential damage. I incline to the view that, in their context, the words are equivalent to 'in so far as' or 'in circumstances in which' and do not permit the kind of judgment of Solomon illustrated by the example. But for the purpose of deciding this appeal I find it unnecessary to express a concluded view on this question.

My Lords, at long last I turn to the application of the statutory language to the circumstances of the case. Of the particular matters to which attention is directed by paragraphs (a) to (e) of section 55 (5), only those in (a) to (c) are relevant. As to paragraph (c), the respondents admittedly knew of the relevant condition (they had dealt with the appellants for many

years) and, if they had read it, particularly clause 2, they would, I think, as laymen rather than lawyers, have had no difficulty in understanding what it said. This and the magnitude of the damages claimed in proportion to the price of the seeds sold are factors which weigh in the scales in the appellants' favour.

The question of relative bargaining strength under paragraph (a) and of the opportunity to buy seeds without a limitation of the seedsman's liability under paragraph (b) were interrelated. The evidence was that a similar limitation of liability was universally embodied in the terms of trade between seedsmen and farmers and had been so for very many years. The limitation had never been negotiated between representative bodies but, on the other hand, had not been the subject of any protest by the National Farmers' Union. These factors, if considered in isolation, might have been equivocal. The decisive factor, however, appears from the evidence of four witnesses called for the appellants, two independent seedsmen, the chairman of the appellant company, and a director of a sister company (both being wholly-owned subsidiaries of the same parent). They said that it had always been their practice, unsuccessfully attempted in the instant case, to negotiate settlements of farmers' claims for damages in excess of the price of the seeds, if they thought that the claims were 'genuine' and 'justified'. This evidence indicated a clear recognition by seedsmen in general, and the appellants in particular, that reliance on the limitation of liability imposed by the relevant condition would not be fair or reasonable.

Two further factors, if more were needed, weight the scales in favour of the respondents. The supply of autumn, instead of winter, cabbage seeds was due to the negligence of the appellants' sister company. Irrespective of its quality, the autumn variety supplied could not, according to the appellants' own evidence, be grown commercially in East Lothian. Finally, as the trial judge found, seedsmen could insure against the risk of crop failure caused by supplying the wrong variety of seeds without materially increasing the price of seeds.

My Lords, even if I felt doubts about the statutory issue, I should not, for the reasons explained earlier, think it right to interfere with the unanimous original decision of that issue by the Court of Appeal. As it is, I feel no such doubts. If I were making the original decision, I should conclude without hesitation that it would not be fair or reasonable to allow the appellants to rely on the contractual limitation of their liability.

I would dismiss the appeal.

Lord Diplock delivered a short concurring speech. **Lord Scarman**, **Lord Roskill**, and **Lord Brightman** concurred.

Commentary

A number of points should be noted about this case. First, the case is concerned with the construction of the now repealed section 55 of the Sale of Goods Act 1979. The factors listed in section 55(4) are, however, very similar to those listed in Schedule 2 to the Unfair Contract Terms Act 1977 and so the case is one of some significance for the interpretation of the 1977 Act. Secondly, Lord Bridge sets out a very limited role for appellate courts when reviewing decisions of lower courts on the reasonableness or otherwise of a particular clause. An appellate court should 'refrain from interference… unless satisfied that [the original decision] proceeded upon some erroneous principle or was plainly and obviously wrong.' Thirdly, Lord Bridge notes the issue relating to the meaning of 'to the extent that' (see p. 435, Section 3). While he states that, in his view, the court does not have jurisdiction to make an order to the effect that a party is entitled to recover half his consequential losses, he is careful to say that it is 'unnecessary to express a concluded view on this question'. Finally, the 'decisive factor' which led Lord Bridge to conclude that the term was unreasonable was the 'recognition

by seedsmen in general . . . that reliance on the limitation of liability . . . would not be fair or reasonable' (see further on this point, p. 436, Section 3).

Phillips Products Ltd v. Hyland
[1987] 1 WLR 659, Court of Appeal

The second defendants, Hamstead Plant Hire Co Ltd, hired an excavator to the plaintiffs, Phillips Products Ltd. The excavator was driven by the first defendant, Mr Hyland, who was also hired out to the plaintiffs. The contract of hire incorporated the Contractors' Plant Association ('CPA') conditions, Condition 8 of which stated:

> 'When a driver or operator is supplied by the owner to work the plant, he shall be under the direction and control of the hirer. Such drivers or operators shall for all purposes in connexion with their employment in the working of the plant be regarded as the servants or agents of the hirer who alone shall be responsible for all claims arising in connexion with the operation of the plant by the said drivers and operators. The hirer shall not allow any other person to operate such plant without the owner's previous consent to be confirmed in writing.'

Considerable damage was done to the plaintiffs' buildings as a result of Mr Hyland's negligence while operating the excavator. The plaintiffs brought an action for damages against both defendants in respect of the loss that they had suffered as a result of the negligence of Mr Hyland. The claim succeeded before the trial judge. The second defendants appealed to the Court of Appeal and relied upon condition 8 by way of defence. The Court of Appeal dismissed the appeal and held that condition 8 fell within the scope of section 2(2) of the Unfair Contract Terms Act 1977 and that the trial judge's conclusion that the clause was unreasonable was neither plainly and obviously wrong nor based on an erroneous principle. This being the case, condition 8 did not provide the second defendants with a defence to the plaintiffs' claim and they were, accordingly, liable in damages to the plaintiffs.

Slade LJ [delivered the judgment of the court]

The issues arising on the appeal

The principal question arising on this appeal concerning the applicability or otherwise of the Act . . . itself gave rise to three issues. The first two do not appear to have been argued before the learned Judge . . . No objection, however, was raised on behalf of Phillips to these points being taken . . . These three issues are:

(i) On the admitted facts of the present case, was there on the part of Hamstead 'negligence' within the definition of that word contained in section 1(1) of the Act?

(ii) If the answer to (i) is 'yes', is condition 8 a contract term which, apart from the effect of the Act, can properly be said to 'exclude or restrict' Hamstead's liability for negligence within the meaning of these words in section 2(2) of the Act? In considering this issue, it is necessary to bear in mind the concluding words of section 13(1) which bring within the ambit of section 2(2) terms 'which exclude or restrict the relevant obligation or duty'.

(iii) If the answers to (i) and (ii) are both 'Yes', does condition 8 satisfy the requirement of reasonableness, within the meaning of that phrase as used in the Act?

Issue (i)

As to (i), the argument for Hamstead is simple, and runs on these lines. If a claim is based on contract, 'negligence' within the definition of section 1(1)(a) can have occurred only if there

has been a breach 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'. So, it is said, if in the case of such a claim the contract has by its express terms excluded liability for negligence, there can ex hypothesi have been no breach of any obligation of the nature referred to in section 1(1)(a).

The claim in the present case, as it happens, is of the nature referred to in section 1(1)(b); the breach of a common law duty to take reasonable care is alleged. Here again a similar argument is advanced. It is suggested that there can be no breach of a common law duty to take reasonable care within the meaning of section 1(1)(b), by a party to a contract which contains a condition which purports to absolve him from liability for negligence.

These arguments, though superficially attractive, are in our judgment fallacious. If correct, they would make nonsense of the 1977 Act. They would mean that the very contractual term which pre-eminently is suitable to be subject to review for reasonableness under the Act would be taken out of its scope. The Act, however, is not nonsensical. Its purpose is not defeated by the wording of its first section. In our judgment, in considering whether there has been a breach of any obligation of the nature referred to in (a) or of any duty of the nature referred to in (b) or (c), the court has to leave out of account, at this stage, the contract term which is relied on by the defence as defeating the plaintiffs' claim for breach of such obligation or such duty, and section 1(1) should be construed accordingly.

If any support were necessary for this construction of section 1(1), it is to be found in the concluding words of section 13(1) of the Act. For these words make it clear that section 2 is capable of negating the effect of contract terms which purport to exclude or restrict 'the relevant obligation or duty' . . .

Accordingly, though the validity of condition 8 still remains to be considered, on the admitted facts of this case there was 'negligence' on the part of Hamstead falling within section 1(1)(b) of the Act. This took the form of a breach (subject to the effect, if any, of condition 8) of Hamstead's common law duty to take reasonable care, by reason of the fact that Mr Hyland who, subject to condition 8, was Hamstead's servant, had caused the loss to Phillips by his negligence in the performance of his duties as such servant.

Issue (i) therefore has to be answered 'Yes'.

Issue (ii)

Issue (ii) brings us to section 2(2). Subsection (1) does not apply because there was, fortunately, no death or personal injury. Section 2(2), set out as incorporating the relevant wording of subsection (1), provides that in case of other loss or damage a person cannot by reference to any contract term exclude or restrict his liability for negligence except in so far as the term satisfies the requirement of reasonableness. The argument for Hamstead is that they do not, by reference to condition 8, 'exclude or restrict' their liability for negligence. Condition 8, it is stressed, is not an 'excluding' or 'restricting' clause. It may have an effect on the liability for negligence which would otherwise have existed if there were, as there was in the present case, negligence. (For 'may' we would substitute 'must' assuming that Hamstead's submission as to the validity of condition 8 is correct). Nevertheless, the condition does not, it is said, amount to an attempt by either party to the contract to 'exclude or restrict' liability: it is simply an attempt on their part to divide and allocate the obligations or responsibilities arising in relation to the contract by transferring liability for the acts of the operator from the plant owners to the hirers. A transfer, it is suggested, is not an exclusion; hence the hirers fail at the section 2(2) hurdle . . .

We are unable to accept that in the ordinary sensible meaning of words in the context of section 2 and the Act as a whole, the provisions of condition 8 do not fall within the scope of

section 2(2). A transfer of liability from A to B necessarily and inevitably involves the exclusion of liability so far as A is concerned. . . . On the particular facts of this case the effect of condition 8, if valid, is to negate a common law liability in tort which would otherwise admittedly fall on the plant-owner. The effect of condition 8 making 'the hirer alone responsible for all claims' necessarily connotes that by the condition the plant-owner's responsibility is excluded: In applying section 2(2), it is not relevant to consider whether the form of a condition is such that it can aptly be given the label of an 'exclusion' or 'restriction' clause. There is no mystique about 'exclusion' or 'restriction' clauses. To decide whether a person 'excludes' liability by reference to a contract term, you look at the effect of the term. You look at its substance. The effect here is beyond doubt. Hamstead does most certainly purport to exclude its liabilities for negligence by reference to condition 8. Furthermore, condition 8 purports to 'exclude or restrict the relevant obligation or duty' within the provisions of section 13(1) of the Act.

Issue (ii) has to be answered 'Yes'.

Issue (iii)

Issue (iii) is the issue which alone it would seem, apart from the construction of condition 8 itself, the learned Judge was asked to decide. Does the condition, on the evidence and in the context of the contract as a whole, satisfy the 'requirement of reasonableness', as defined by section 11(1) and elsewhere in the Act?

Under section 11(5) the onus falls on Hamstead to show that condition 8 satisfies the condition of reasonableness. For this purpose having regard to section 11(1), it has to show that that condition was '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'. As the learned Judge pointed out, all the relevant circumstances were known to both parties at that time. The task which he therefore set himself was to examine all the relevant circumstances and then ask himself whether, on the balance of probabilities, he was satisfied that condition 8, in so far as it purported to exclude Hamstead's liability for Mr Hyland's negligence, was a fair and reasonable term. As to these matters, his conclusions as set out in his judgment were as follows:

> 'What then were the relevant circumstances? First, the second defendants carried on the business of hiring out plant and operators. In contrast the plaintiffs were steel stockholders, and as such had no occasion to hire plant except on the odd occasions when they had building work to be done at their premises. There had been apparently only three such occasions: one in 1979, one in July 1980 when the drainage trench was dug and the final occasion when the drainage was done in August 1980.
>
> Secondly, the hire was to be for a very short period. It was arranged at very short notice. There was no occasion for the plaintiffs to address their mind to all the details of the hiring agreement, nor did they do so. The inclusion of condition 8 arose because it appeared in the second defendants' printed conditions. It was not the product of any discussion or agreement between the parties.
>
> Thirdly, there was little if any opportunity for the plaintiffs to arrange insurance cover for risks arising from the first defendant's negligence. Insofar as the first defendant was to be regarded as the plaintiffs' servant it might have been an easy matter to ensure that the plaintiffs' insurance policies were extended, if necessary, to cover his activities in relation to third party claims. Any businessman customarily insures against such claims. He does not usually insure against damage caused to his own property by his own employees' negligence. Thus to arrange insurance cover for the first defendant would have required time and a special and unusual arrangement with the plaintiffs' insurers.

Fourthly, the plaintiffs played no part in the selection of the first defendant as the operator of the JCB. They had to accept whoever the second defendant sent to drive the machine. Further, although they undoubtedly would have had to, and would have had the right to tell the JCB operator what job he was required to do, from their previous experience they knew they would be unable in any way to control the way in which the first defendant did the job that he was given. They would not have had the knowledge to exercise such control. All the expertise lay with the first defendant. I do not think condition 8 could possibly be construed as giving control of the matter of operation of the JCB to the plaintiffs. Indeed in the event the first defendant made it perfectly plain to Mr Pritchard, the plaintiffs' builder, that he would brook no interference in the way he operated his machine.

Those being the surrounding circumstances, was it fair and reasonable that the hire contract should include a condition which relieved the second defendants of all responsibility for damage caused, not to the property of a third party but to the plaintiff's own property, by the negligence of the second defendants' own operators? This was for the plaintiffs in a very real sense a "take it or leave it" situation. They needed a JCB for a simple job at short notice. In dealing with the second defendants they had the choice of taking a JCB operator under a contract containing some 43 written conditions or not taking the JCB at all. The question for me is not a general question whether any contract of hire of the JCB could fairly and reasonably exclude such liability, but a much more limited question as to whether this contract of hire entered into in these circumstances fairly and reasonably included such an exemption.

I have come to the conclusion that the second defendants have failed to satisfy me that condition 8 was in this respect a fair and reasonable term.'

Before reverting to the conclusions and reasoning of the learned Judge, it is unfortunately necessary to deviate from the arguments as they were presented to us. Schedule 2 of the Act contains what are called ' "guidelines" for Application of Reasonableness Test'. These guidelines state:

[he set out the guidelines (on which see p. 444, Section 3) and continued]

We were told that the guidelines in Schedule 2 of the Act were not applicable in this case. It would seem, on a study of the provisions of the Act to which we were not referred in argument, that this may have been wrong. The contract here was a contract of hire. Normally in such a contract, and it would seem consistently with the provisions of the general conditions in this case, the hirer takes possession of the article hired. Therefore, it appears to us that subsection (3) of section 7 (which we do not think it necessary to quote) would apply and thus render Schedule 2 applicable. On this basis the guidelines would fall to be considered. Fortunately, however, in view of the way in which the case has been argued on both sides, no difficulty arises on this account. Guideline (d) is, on any footing, irrelevant. Guidelines (a), (b) and (c) were argued as factors properly to be taken into account, even though not because of the guidelines themselves. Guideline (e) would no doubt have been mentioned in argument if counsel on either side had thought that it affected their decision as to 'fair and reasonable' in this case.

In approaching the learned Judge's reasons and conclusions on this issue, four points have, in our judgment, to be borne in mind.

First, as the learned Judge himself clearly appreciated, the question for the court is not a general question whether or not condition 8 is valid or invalid in the case of any and every contract of hire entered into between a hirer and a plant owner who uses the relevant CPA Conditions. The question was and is whether the exclusion of Hamstead's liability for negligence satisfied the requirement of reasonableness imposed by the Act, in relation to this particular contract.

Secondly, we have to bear in mind that the relevant circumstances, which were or should have been known to or contemplated by the parties, are those which existed when the contract

was made. Section 11(1) is specific on that point. Hence, evidence as to what happened during the performance of the contract must, at best, be treated with great caution. . . .

Thirdly, the burden of proof falling upon the owner under section 11(5) of the Act is, in our judgment, of great significance in this case in the light, or rather in the obscurity, of the evidence and the absence of evidence on issues which were, or might have been, relevant on the issue of reasonableness. One particular example is the matter of insurance. The insurance position of all the parties was canvassed to some extent in oral evidence at the trial, but such evidence seems to us to have been singularly imprecise and inconclusive.

Finally, by way of approach to the issue of reasonableness, it is necessary to bear in mind, and strive to comply with, the clear and stern injunction issued to appellate courts by Lord Bridge in his speech, concurred in by the other members of their Lordships' House, in *Mitchell (George) (Chesterhall) Ltd* v. *Finney Lock Seeds Ltd* [1983] 2 AC 803 at pp. 815–816:

[he set out a passage from the speech of Lord Bridge which is extracted at p. 447, earlier in this section, and continued]

In the context of issue (iii), criticism has been made by Hamstead's counsel of some parts of the learned Judge's reasoning. It is said that in some respects he misunderstood or misrecollected the evidence. Some of the evidence was indeed confused and not easy to follow. It is, in some passages, difficult to be confident what was really meant. It may be that the learned Judge placed more stress than we would think right on the lack of opportunity of Mr Phillips to study and understand the conditions, and in particular condition 8. But this is the very sort of point to which Lord Bridge referred in saying that there is room for a legitimate difference of judicial opinion.

Against this, there is to be set the fact, as it appeared at the trial, that the general conditions with their 43 clauses were adopted by and used by all the members of the Trade Association to which Hamstead belonged. . . . Thus, we think he was justified in saying that in dealing with Hamstead this was for Phillips in a very real sense a 'take it or leave it situation'. As he said, they needed a JCB for a simple job at short notice and, in dealing with Hamstead, had the choice of taking a JCB operator under the general conditions or not taking the JCB at all. Even if Mr Phillips had understood and had been worried by the effect of condition 8 before he arranged for the conclusion of the earlier contracts or before he authorized Mr Pritchard to conclude the contract in August 1980 now in question, it is reasonable to assume, on the evidence as it stood, that he would not have thought that there was much that he could do about it, except to take the conditions offered. It is fair to say that we were told that various changes had been made, including the alterations to some of the general conditions since the coming into force of the Act and that the position today might be very different. But counsel for Hamstead necessarily and realistically accepts that we have to deal, as the learned Judge had to deal, with the contractual terms as they were and with the facts as to relevant considerations as they were given in evidence at the trial, not as the terms are now or as the relevant facts might have appeared to be if further evidence had been given.

As appears from the passage which we have cited, other matters which influenced the Judge in his decision on unreasonableness, and which we think were clearly relevant factors to be weighed in the balance, were that the hirers could play no part in the selection of the operator who was to do the work. Nor did the general conditions contain any warranty by Hamstead as to his fitness or competence for the job. Furthermore, despite the words in condition 8 'he shall be under the direction and control of the hirer', we think it reasonable to infer that the parties, when they made the contract, would have assumed that the operator would be the expert in the management of this machine and that he would not, and could not be expected to, take any instructions from anyone representing the hirers as to the manner in which he would operate the machine to do the job, once the extent and nature of the job had

been defined to him by the hirers; in short they would tell him what to do but not how to do it. If such evidence is admissible, which we do not find it necessary to decide, this inference would be strongly supported by the evidence of what actually happened on the site before the accident occurred.

It may be that in several respects this is a very special case on its facts, its evidence and its paucity of evidence. But on these facts and on the available evidence, we are wholly unpersuaded that the learned Judge proceeded upon some erroneous principle or was plainly and obviously wrong in his conclusion that Hamstead had not discharged the burden upon them of showing that condition 8 satisfied the requirements of reasonableness in the context of this particular contract of hire. It is important therefore that our conclusion on the particular facts of this case should not be treated as a binding precedent in other cases where similar clauses fall to be considered but the evidence of the surrounding circumstances may be very different.

Issue (iii) accordingly has to be answered 'No' and we dismiss this appeal.

Commentary

There were two principal issues at stake in *Phillips*. The first was a jurisdictional issue, namely whether or not the Act applied to condition 8, and the second was the application of the reasonableness test to the clause. The jurisdictional issue is the more difficult of the two. It had two aspects to it, being issues (i) and (ii) in the judgment. In issue (i) the second defendants submitted that they had not been negligent while in issue (ii) they denied that condition 8 was a clause that attempted to 'exclude or restrict' liability. The essence of the defence was the same in both issues, namely that condition 8 had the effect of defining the obligations of the parties and did not provide the defendants with a defence to a breach of an obligation. The Court of Appeal rejected both arguments. Slade LJ held that, when deciding whether or not a defendant has been negligent, the court must leave out of account, at least initially, the contract term which is relied on by the defendant in order to defeat the plaintiff's claim for damages for breach of the duty to take reasonable care. The reasoning here is difficult. Why choose to leave the exclusion clause out of account when seeking to identify the obligations that have been assumed by the parties when the exclusion clause may be an integral part of the definition of the obligations of the parties? The Court of Appeal gave two answers to this question. First, the conclusion that there had been no negligence on the part of the defendants would have made 'nonsense of the Act' because it would have taken condition 8, and many other clauses, outside the scope of the Act. There is obvious force in this point but it can be countered by the argument that the Act is itself based on a false premise. The Act generally assumes that the function of an exclusion clause is to provide the defendant with a defence to a breach of duty, whereas it can be argued that the true function of an exclusion clause is to assist in the definition of the obligations which the parties have assumed (see Coote, p. 456, Section 5). The second answer given by the Court of Appeal was that section 13(1) of the Act extends the scope of section 2 to clauses that purport to exclude or restrict 'the relevant obligation or duty'. The House of Lords in *Smith* v. *Eric S Bush* [1990] 1 AC 831 also relied upon section 13 when rejecting an argument advanced on behalf of the defendant surveyor that his disclaimer fell outside the scope of section 2 because its effect was to negate the duty of care rather than provide him with a defence in respect of his breach of duty. It is true that section 13 extends the scope of the Act to certain duty-defining clauses, as does section 3(2)(b), but the problem with the section lies in identifying which duty-defining clauses fall within its scope and which do not.

The jurisdictional issue raised in issue (ii) is also a difficult one. Here the second defendants submitted that condition 8 did not seek to 'exclude or restrict' a liability. They submitted that the effect of the clause was to 'transfer' a liability from themselves to the plaintiffs and that 'a transfer…is not an exclusion'. The Court of Appeal rejected this submission stating that 'a transfer of liability from A to B necessarily and inevitably involves the exclusion of liability as far as A is concerned'. The subsequent decision of the Court of Appeal in *Thompson* v. *T Lohan (Plant Hire) Ltd* [1987] 1 WLR 649 demonstrates that matters are not quite so straightforward (and see also *Jose* v. *MacSalvors Plant Hire Ltd* [2009] EWCA Civ 1329, [2009] All ER (D) 143 (Dec)). The case is factually similar to *Phillips* but the conclusion was different. An excavator and a driver, Mr Hill, were hired out by the first defendants, T Lohan (Plant Hire) Ltd, to a third party. The plaintiff's husband was killed in an accident caused by the negligence of the driver of the excavator. The plaintiff brought an action in negligence against the first defendants. The claim succeeded and the first defendants then sought an indemnity from the third party pursuant to condition 8 (which was in substance the same condition 8 as was in issue in *Phillips*). The third party denied any liability to indemnify the first defendants on the basis that condition 8 was an exclusion clause which was invalidated by section 2(1) of the 1977 Act. The Court of Appeal rejected this submission and held that the Act had no application to condition 8. Fox LJ stated (at pp. 656–657) that there was a 'sharp distinction' between the present case and *Phillips* and that the distinction was that:

> whereas in the *Phillips* case there was a liability in negligence by Hamstead to Phillips (and that was sought to be excluded), in the present case there is no exclusion or restriction of the liability sought to be achieved by reliance on the provisions of condition 8. The plaintiff has her judgment against Lohan and can enforce it. The plaintiff is not prejudiced in any way by the operation sought to be established of condition 8. All that has happened is that Lohan and the third party have agreed between themselves who is to bear the consequences of Mr Hill's negligent acts. I can see nothing in section 2(1) of the 1977 Act to prevent that. In my opinion, section 2(1) is concerned with protecting the victim of negligence, and of course those who claim under him. It is not concerned with the arrangements made by the wrongdoer with other persons as to the sharing or bearing of the burden of compensating the victim. In such a case it seems to me there is no exclusion or restriction of the liability at all. The liability has been established by Hodgson J. It is not in dispute and is now unalterable. The circumstance that the defendants have between themselves chosen to bear the liability in a particular way does not affect that liability; it does not exclude it, and it does not restrict it. The liability to the plaintiff is the only relevant liability in the case, as it seems to me, and that liability is still in existence and will continue until discharged by payment to the plaintiff. Nothing is excluded in relation to the liability, and the liability is not restricted in any way whatever. The liability of Lohan to the plaintiff remains intact. The liability of Hamstead to Phillips was sought to be excluded.
>
> In those circumstances it seems to me that, looking at the language of section 2(1) of the 1977 Act, this case does not fall within its prohibition.

While the Court of Appeal in *Phillips* refused to draw a distinction between a clause that 'excluded or restricted' a liability and a clause which 'transferred' a liability, the Court of Appeal in *Thompson* drew a distinction between a clause that 'shared' a liability and one which 'excluded or restricted' a liability. It did so by reading the words 'to the victim of the negligence' into section 2(1) so that the subsection only regulates attempts to exclude or

restrict a liability towards the *victim of the negligence*. This reading of section 2 can, however, have some bizarre consequences. Suppose that Mr Hyland in *Phillips* had damaged the property of a third party instead of the property of the plaintiffs. If the third party sued and recovered damages from Phillips in respect of the property damage, Phillips would have been entitled to an indemnity from Hamstead under condition 8 because, on these facts, there would be no attempt to exclude or restrict a liability towards the victim of the negligence (the third party). But why should the application of the Unfair Contract Terms Act 1977 to condition 8 depend upon whose property has been damaged? Either it is a reasonable condition or it is not. This is not, however, the view of the Court of Appeal. The validity of the clause will turn upon such fortuitous circumstances as the identity of the person who suffers loss as a result of the negligence of the driver.

The second issue at stake in *Phillips* was the application of the reasonableness test to condition 8 (issue (iii) in the judgment). Once again we can see the deference shown by the Court of Appeal to the decision of the trial judge. The Court of Appeal did appear to have some sympathy with the criticisms levelled against 'some parts of the learned Judge's reasoning' but their reservations were not sufficiently strong to lead them to intervene. But they did confine the precedent value of the case by stating that 'in several respects this is a very special case on its facts, its evidence and its paucity of evidence'. This being the case, it cannot be assumed that condition 8 of the CPA conditions will be unreasonable in all cases: much will depend on the facts of the individual cases. Given the widespread use of the CPA conditions, this conclusion is unlikely to be a welcome one.

5. CONCLUSION: DEFENCE OR DEFINITION?

One of the issues that has surfaced from time to time in this chapter relates to the nature of an exclusion clause. Is the function of the clause to assist in the definition of the obligations that the parties have assumed or is its function to provide a defendant with a defence to a breach of an obligation? The judges have tended to adopt the latter view and have conceived of exclusion clauses in defensive rather than definitional terms. The Unfair Contract Terms Act 1977, with the exceptions of sections 3(2)(b) and 13(1), makes the same assumption. This assumption has been challenged, most notably, by Professor Coote. The essence of his analysis of the nature of an exclusion clause is to be found in the following extract:

B Coote, *Exception Clauses*
(Sweet & Maxwell, 1964), pp. 9–11 and 17–18

A suggested classification of exception clauses

All exception clauses . . . fall within one or other of the two following classes, which it is proposed to call 'Type A' and 'Type B' respectively:

Type A: exception clauses whose effect, if any, is upon the accrual of particular primary rights.

Thus, where words relating to quality have been employed by a vendor of goods, an exclusion of conditions, warranties, or undertakings as to quality, helps determine the extent to which those words are contractually binding as, by the same token, would a stipulation by the vendor that he should not be required to make compensation for poor quality.

Type B: Exception clauses which qualify primary or secondary rights without preventing the accrual of any particular primary right.

Examples would be limitations on the time within which claims might be made, and limitations as to the amount which might be recovered on a claim. By contrast, a clause which purported to take away a buyer's right to reject goods would belong to Type A.

To bring it within Type A, an exception may operate either directly or indirectly. The direct effect requires little elaboration. If we suppose, for example, a promise in general terms, and a series of particular exceptions from that promise, we have a case where an exception clause is directly limiting the substantive contractual content of a promise, or more technically, perhaps, is negativing any primary right to performance of those matters excluded from the promise. Thus, where a horse is sold warranted sound 'except for hunting', a purchaser will have no primary right to call for a horse sound for hunting. An exception may have the same effect indirectly, through the operation of the proposition that it is impossible to create valid contractual rights while at the same time agreeing that they shall be at all times unenforceable. A total exclusion, either of sanctioning rights or of procedural rights of enforcement, would have the effect of making the apparent primary right unenforceable. In so far as the 'unenforceable right' would be illusory (that is, would have no existence as a contractual right), exceptions of this type would, accordingly, have the effect on primary rights of preventing their accrual. Thus, if the vendor of a horse should represent that the animal is sound but stipulate that he shall not be required to make compensation if it should prove to be unsound, then unless he is merely contradicting himself, he is indicating thereby that his representation is a 'mere' representation and that he refuses to contract as to the horse's soundness. In other words, by excluding sanctioning rights he is indirectly preventing the purchaser from acquiring any contractual primary right as to soundness. Similarly, if the vendor should exclude sanctioning rights by providing that 'this agreement shall not be justiciable in the courts of any place or in any circumstances' then, either that provision is void as ousting the jurisdiction of the courts, or it indicates that the agreement is an 'honour' agreement which does not give rise to contractual rights and duties and which is binding in the moral sense only.

By contrast, exceptions of Type B do not affect the question of whether particular primary rights shall accrue, but merely qualify rights which *ex hypothesi* do accrue. There are three ways in which they can do this. First, they may act directly on a primary right, as by placing a limit on its duration. To take again the sale of a horse 'warranted sound', a provision that unless the horse were returned within three days it would be deemed sound would be an exception clause to this second Type. It would not prevent a valid primary right to soundness from arising. Secondly, they may act directly on sanctioning rights, as by placing a limit on the amount recoverable for breach of particular primary rights. The carrier's notice limiting his liability to £5 in respect of any one package is a familiar example. Again, a valid primary right to performance arises despite the exception. Finally, the exception may lay down a time limit within which an action may be brought. Whether such limitations act directly on sanctioning rights, or only indirectly by controlling procedural rights, the result is the same. Once the time-limit has expired, the primary rights concerned become unenforceable and are extinguished or fulfilled. But, until that time, they subsist as valid contractual rights. In other words, the exception does not prevent particular primary rights accruing.

It ought, perhaps, to be emphasised that both types of exception clause help define and delimit the rights to which they apply. One result of this is that rights affected by exceptions of Type B are qualified from their inception by the exception clause just as much as are the rights affected by clauses of Type A. What makes the distinction between the two types significant and important is that if the effect of clauses of Type A is upon whether particular

primary rights shall arise from a promise, they are directly relevant to the existence or otherwise, in that promise, of substantive contractual content. Since promises are ordinarily expressed in a number of words, or may have more than one aspect, the Type A exception may help to determine how many of the words used give rise to rights and duties, or in how many aspects the promise has contractual force. In the ordinary way a contractual promise may give rise to a whole complex of rights. It can be the function of an exception clause to show how many of these rights do in fact come into existence. Where the question is, 'has the promisor contracted to do this or this?' an exception of Type A will have a direct bearing on the answer . . .

Conclusion

If the argument so far has been accepted, it follows that the true juristic function and effect of exception clauses are quite different from those currently ascribed to them by the courts. Instead of being mere shields to claims based on breach of accrued rights, exception clauses substantively delimit the rights themselves. A large class of them prevent those rights from ever arising in the first place. As it has been put in an American publication: 'the ordinary function of an exception is to take out of the contract that which otherwise would have been in it, or to guard against misinterpretation'.

So regarded, the exception clause of Type A is seen to fulfil a function not unlike that of an exception from grant, an analogy which, incidentally, did not escape lawyers of the early nineteenth century. Just as an exception from grant operates immediately to prevent its subject passing to the grantee, so an exception clause of Type A operates immediately to prevent its subject forming part of the rights and duties created by the contract.

It may seem feasible that the parties should have intended a contractual duty to remain when they excluded liability for its breach, but this is in reality a juristic impossibility. A duty of sorts there may be, but it will be a duty of honour, not a contractual one.

It would follow, then, that the current approach to exception clauses is based on a fallacy.

The analysis is a powerful one. But it has been attacked by Professors Adams and Brownsword (1988) 104 *LQR* 94, 95 on the ground that it is 'elegantly formalistic' and that it 'ignored both the historical development of the problem, and the realities of the situation. Its implicit rejection by the draftsmen of UCTA was both realistic and right.' The objection that the Coote thesis is 'elegantly formalistic' is an interesting one but it can be countered by pointing out that the source of the formalism could be said to be the Unfair Contract Terms Act itself and not Professor Coote. That this is so is demonstrated by cases such as *Thompson* v. *T Lohan (Plant Hire) Ltd* and *Phillips Products Ltd* v. *Hyland* [1987] 1 WLR 659 (both discussed in Section 4) where the issue before the Court of Appeal was whether or not a distinction should be drawn between a clause which 'excludes or restricts' a liability and a clause which either 'transfers' or 'shares' a liability. Any attempt to regulate clauses which 'exclude or restrict' liability but not other clauses is bound to throw up questions relating to the meaning of 'exclude or restrict'. To use one of Coote's examples, is there a difference between a case where a horse is sold warranted sound 'except for hunting' and a horse which is sold warranted sound but the warranty is followed by a clause which provides that 'no liability is accepted for any injury or loss suffered when using the horse for hunting'? The latter would appear to be an exclusion clause but what about the former? The reason that we have to ask the question whether or not a contract term which states that a horse that is warranted sound 'except for hunting' is an exclusion clause is not because of Coote's thesis but

because the Act requires us to ask the question. Had the Act enacted a general control over all unreasonable terms in standard form contracts these jurisdictional issues would not have arisen (except in relation to the definition of a 'standard form contract').

FURTHER READING

Adams, J and Brownsword, R, 'The Unfair Contract Terms Act: A Decade of Discretion' (1988) 104 *LQR* 94.

Coote, B, *Exception Clauses* (Sweet & Maxwell, 1964).

Palmer, N and Yates, D, 'The Future of the Unfair Contract Terms Act 1977' [1981] *CLJ* 108.