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13. Exclusion Clauses

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Abstract

This chapter discusses one particular type of boilerplate clause, namely the exclusion or limitation clause. The chapter examines the role and function of exclusion and limitation clauses in modern commercial contracts. In order to perform its function an exclusion or limitation clause must (i) be validly incorporated into the contract, (ii) cover the loss that has been suffered, and (iii) survive scrutiny under the Unfair Contract Terms Act 1977. Difficult interpretative issues can arise where one party seeks to exclude liability in respect of its own negligence or exclude liability for fundamental breach. The Unfair Contract Terms Act 1977 applies a reasonableness test to a number of exclusion or limitation clauses. The 1977 Act is also examined, with particular reference to the types of clause that fall within its scope.

Keywords: English contract law, exclusion clause, limitation clause, excluding liability for negligence, fundamental breach, Unfair Contract Terms Act 1977, reasonableness

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 and limitation 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 the reasonableness test, then it can be a difficult matter to decide whether or not a term satisfies that test.

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13.1 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 9.3) 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 (see 9.3) and *Thornton* v. *Shoe Lane Parking Ltd* [1971] 2 QB 163 (see 9.3). 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.

p. 412 ↵ 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 (see 9.3) and *Thornton* v. *Shoe Lane Parking Ltd* [1971] 2 QB 163 (see 9.3) 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 modern authority suggests 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) it cannot be said that they have entirely disappeared (see, for example, *AEG (UK) Ltd* v. *Logic Resource Ltd* [1996] CLC 265, see 9.3). The law is currently in a state of transition and some of the old cases, which adopt a restrictive approach to the interpretation of exclusion clauses, may no longer be followed.

A contracting party which wishes to rely on an exclusion or limitation clause in order to exclude or limit its
p. 413 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, see 9.3). But this is by no means a necessary inference. The mere fact that the clause in question is a limitation or exclusion clause does not of itself mean that it is onerous or unusual (*Goodlife Foods Ltd* v. *Hall Fire Protection Ltd* [2018] EWCA Civ 1371, [2018] BLR 491, [35]). So, 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).

13.2 Interpretation

In the past the courts applied extremely restrictive rules to the interpretation of exclusion and limitation clauses. That restrictive approach was perhaps best expressed by Lord Denning 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. …
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> p. 414 ↵ 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.

In the same judgment, however, Lord Denning acknowledged that the need for these restrictive rules had largely, if not entirely, disappeared as a result of the enactment of the Unfair Contract Terms Act 1977 and he observed that the courts 'should no longer have to go through all kinds of gymnastic contortions to get round them'.

The approach of the modern courts is a much more straightforward one which applies to exclusion and limitation clauses the same principles as would be applied to any other term of the contract (on which see Chapter 11), subject to the requirement that clear words are needed if one party is effectively to restrict or take away from the other party a valuable right. This approach was summarized by Lord Leggatt (in a judgment with which Lord Burrows agreed) in *Triple Point Technology Inc* v. *PTT Public Co Ltd* [2021] UKSC 29, [2021] AC 1148, [107]–[111] in the following terms:

107. The approach of the courts to the interpretation of exclusion clauses (including clauses limiting liability) in commercial contracts has changed markedly in the last 50 years. Two forces have been at work. One has been the impact of the Unfair Contract Terms Act 1977, which provided a direct means of controlling unreasonable exclusion clauses and removed the need for courts to resort to artificial rules of interpretation to get around them: see Lord Denning's swansong in *George Mitchell (Chesterhall) Ltd* v. *Finney Lock Seeds Ltd* [1983] QB 284, 296–301; and *Bank of Credit and Commerce International SA* v. *Ali* [2001] UKHL 8; [2002] 1 AC 251, paras 57–60 (Lord Hoffmann). This change of attitude was heralded by the decision of the House of Lords in *Photo Production Ltd* v. *Securicor Transport Ltd* [1980] AC 827. The second force has been the development of the modern approach in English law to contractual interpretation, with its emphasis on context and objective meaning and deprecation of special 'rules' of interpretation—encapsulated by Lord Hoffmann's announcement in *Investors Compensation Scheme Ltd* v. *West Bromwich Building Society* [1998] 1 WLR 896 at 912 that 'almost all the old intellectual baggage of "legal" interpretation has been discarded'.

108. The modern view is accordingly to recognise that commercial parties are free to make their own bargains and allocate risks as they think fit, and that the task of the court is to interpret the words used fairly applying the ordinary methods of contractual interpretation. It also remains necessary, however, to recognise that a vital part of the setting in which parties contract is a framework of rights and obligations established by the common law (and often now codified in statute). These comprise duties imposed by the law of tort and also norms of commerce which have come to be recognised as ordinary incidents of particular types of contract or relationship and which often take the form of terms implied in the contract by law. Although its strength will vary according to the circumstances of the case, the court in construing the contract starts from the assumption that in the absence of clear words the parties did not intend the contract to derogate from these normal rights and obligations.

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109. The first and still perhaps the leading statement of this principle is that in *Modern Engineering (Bristol) Ltd* v. *Gilbert-Ash (Northern) Ltd* [1974] AC 689 ('*Gilbert-Ash*'). ...

111. To the extent that the process has not been completed already, old and outmoded formulas such as the three-limb test in *Canada Steamship Lines Ltd v The King* [1952] AC 192, 208, and the 'contra proferentem' rule are steadily losing their last vestiges of independent authority and being subsumed within the wider *Gilbert-Ash* principle. As Andrew Burrows QC, sitting as a Deputy High Court Judge, said in *Federal Republic of Nigeria v JP Morgan Chase Bank NA* [2019] EWHC 347 (Comm); [2019] 1 CLC 207, para 34(iii):

> 'Applying the modern approach, the force of what was the *contra proferentem* rule is embraced by recognising that a party is unlikely to have agreed to give up a valuable right that it would otherwise have had without clear words. And as Moore-Bick LJ put it in the *Stocznia* case, at para 23, 'The more valuable the right, the clearer the language will need to be'. So, for example, clear words will generally be needed before a court will conclude that the agreement excludes a party's liability for its own negligence.'

Three points should be noted in relation to Lord Leggatt's analysis of the development of the law. First, he notes at ([111]) that the 'contra proferentem rule' is losing its authority. The contra proferentem rule was (and perhaps still is) a rule of general application in the law of contract (see *Tan Wing Chuen* v. *Bank of Credit and Commerce Hong Kong Ltd* [1996] 2 BCLC 69, 77) according to which, in the event of there being an ambiguity in a contract term, the ambiguity was to be resolved against the party relying upon the term. This rule was applied to exclusion clauses with particular venom by the courts to such an extent that, in some cases, the courts appeared to apply the rule in such a way as to create an ambiguity which did not in truth exist 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). A modern court would not take such an approach, particularly in the case of a commercial contract negotiated between parties of equal bargaining power (see *Persimmon Homes Ltd* v. *Ove Arup & Partners Ltd* [2017] EWCA Civ 373, [2017] BLR 417, [52] and *Transocean Drilling UK Ltd* v. *Providence Resources plc* [2016] EWCA Civ 372, [2016] 2 Lloyd's Rep 51, [20]). Given these developments Lord Leggatt would appear to be correct in concluding that the contra proferentem rule, to the extent that it still exists, is of much reduced significance in the modern law.

Secondly, the wider principle identified by Lord Leggatt is that the courts will look for 'clear words' before reaching the conclusion that one party has agreed to give up a valuable right that it would otherwise have had. It may be said that the 'clear words rule' may not be very different in effect from the contra proferentem rule in that both will give effect to an exclusion clause where clear words are used but not when it is ambiguously expressed. While there is force in this point, there are two advantages to the modern approach. The first is
p. 416 that ↵ it avoids the need to identify the 'proferens'. This was a point of potential difficulty with the contra proferentem rule, at least in the case where the contract was the subject of genuine negotiation between the parties. In such a case, given that the clause was the product of negotiation between the parties, who is the proferens? No such difficulty arises in the case of the 'clear words rule' because in order to apply the rule, all that the court needs to do is to identify the party whose rights have been said to have been taken away. The second advantage is that the rule is much easier for contracting parties to understand given its succinct description of the applicable principle.

The third point to note about Lord Leggatt's judgment is his description (at [110]) of the 'normal rights and obligations' the deprivation of which will which attract the operation of the rule. At the margins, it may not be entirely easy to identify what is a 'valuable' or a 'normal' right that will trigger the operation of the rule but any uncertainty here should not give rise to undue difficulty given that one would ordinarily expect a contract term to be drafted clearly. So in requiring that clear words be used, the courts are doing no more than insisting on what would otherwise be good drafting practice.

A good example of the importance of using 'clear words' when drafting an exclusion or limitation clause is to be found in the decision of the Court of Appeal in *Soteria Insurance Ltd (formerly CIS General Insurance Ltd)* v. *IBM UK Ltd* [2022] EWCA Civ 440, [2022] 2 All ER (Comm) 1082. The dispute in this case focused on clause 23.3 of the contract between the parties which provided as follows:

> 'Subject to clause 23.2 and 23.4, neither party shall be liable to the other or any third party for any Losses arising under and/or in connection with this Agreement (whether in contract, tort (including negligence), breach of statutory or otherwise) which are indirect or consequential Losses, or for loss of profit, revenue, savings (including anticipated savings), data ..., goodwill, reputation (in all cases whether direct or indirect) even if such Losses were foreseeable and notwithstanding that a party had been advised of the possibility that such Losses were in the contemplation of the other party or any third party.'

The particular issue in dispute was whether these words were apt to exclude a claim for wasted expenditure of £122 million brought against the defendant, IBM, in respect of an abandoned IT project. The Court of Appeal held that they were not and that this was so whether the ordinary approach to the interpretation of contract terms was applied (see paragraphs [57] and [58] below) or whether the court applied the 'clear words' test (see paragraphs [60]–[62] below). Coulson LJ stated:

> [57] The short point is whether, as a matter of language, the description of the types of losses being excluded, namely 'loss of profit, revenue, savings' is apt to cover or include 'wasted expenditure'. In my view, the fundamental difficulty, which IBM never addressed, let alone surmounted, is that claims for 'wasted expenditure' were not excluded by the terms of clause 23.3 because those words are simply not there.
>
> [58] I consider that the objective meaning of clause 23.3, as understood by a reasonable person in the position of these parties, was that the clause did not exclude a claim for expenditure incurred, but wasted because of the other party's repudiatory breach. Claims for wasted expenditure – costs actually incurred but wasted – were not referred to in clause 23.3 and, on the natural and ordinary meaning of the words, were not included in 'loss of profit, revenue [or] savings'. …
>
> p. 417 [60] My view as to the ordinary and natural meaning of the words is confirmed by the principles relating to the construction of exclusion clauses … The more valuable the right, the clearer the language of any exclusion clause will need to be; the more extreme the consequences, the more stringent the court must be before construing the clause in a way which allows the contract-breaker to avoid liability for what may be his catastrophic non-performance. In my view, there was nothing in clause 23.3 to suggest that the costs, which [the claimant] inevitably incurred in the expectation that [the project] would be completed satisfactorily, would somehow be irrecoverable if IBM repudiated that contract.
>
> [61] … this money was wasted because there never was a new IT system or anything like it. It was money spent in expectation of the contractual benefits that IBM had promised but which, as a result of IBM's repudiatory breach, never materialised. On ordinary principles, that loss would be recoverable as damages. Indeed, in circumstances where such a large amount of money had been wasted, exhaustion and instinctive wariness about the promised benefits of new IT systems in general might well have meant that this was the most likely claim to be made by [the claimant] should IBM repudiate. For the recoverability of such a likely claim to be excluded, the exclusion must be clear and obvious. Yet here, there were no relevant exclusionary words, let alone clear and obvious ones. …
>
> [62] … The parties cannot be taken to have excluded this obvious and common type of damages in circumstances where they have not made any reference in the relevant clause to wasted expenditure at all … clause 23.3 does not begin to suggest that the parties intended that the costs actually incurred and then wasted because of IBM's repudiation of the contract were to be excluded.

The cases in which the courts are most likely to look for 'clear words' are cases in which the effect of an exclusion clause is said to be to 'defeat the main object of the contract' or to 'create a commercial absurdity'. This is because the courts regard it as 'inherently unlikely that the parties intended that the clause should have so wide an ambit as in effect to deprive one party's stipulations of all contractual force such that the contract becomes "a mere declaration of intent."' But, even in the latter context, where the language is fairly susceptible of only one meaning, that meaning must be attributed to it unless 'the meaning is repugnant to the contract'. The conclusion that the contract has become a 'mere declaration of intent' is, however, one that

a court will reach only in exceptional cases where the effect of the clause is 'to relieve one party from all liability for breach of any of the obligations which he has purported to undertake' (*Pinewood Technologies Asia Pacific Ltd v Pinewood Technologies plc* [2023] EWHC 2506 (TCC), [82] and see also *EE Ltd v Virgin Mobile Telecoms Ltd* [2023] EWHC 1989 (TCC)).

Cases in which the courts have historically undertaken a more thorough and careful approach to the interpretation of exclusion clauses include cases where one party claims that it has effectively excluded liability in respect of its own failure to take reasonable care in the performance of its contractual obligations and in the case where it is said that the breach encompasses a breach of a fundamental term of the contract or the breach a core incident of a particular type of contract or relationship. It is to these cases that we now turn before, finally in the context of our consideration of the interpretation of exclusion and limitation clauses, examining the approach which the courts take towards the interpretation of limitation clauses and clauses which seek to exclude liability for 'indirect or consequential loss'.

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13.2.1 Excluding Liability in Negligence

In his judgment in *Triple Point*, Lord Leggatt refers to the 'three-limb test in *Canada Steamship Lines Ltd* v. *The* King' as an authority which is 'steadily losing [its] last vestiges of independent authority.' *Canada Steamship Lines Ltd* v. *The King* [1952] AC 192 was for many years the leading authority on the exclusion or limitation of liability in negligence. The word 'negligence' in an exclusion or limitation clause will ordinarily encompass liability arising in the tort of negligence and liability which flows from the breach of a contractual duty to exercise reasonable care and skill (*Triple Point Technology Inc* v. *PTT Public Co Ltd* [2021] UKSC 29, [2021] AC 1148, [52] and [100]). The three-limb test to which Lord Leggatt refers was set out by Lord Morton of Henryton in *Canada Steamship* in the following terms (at p 208):

> 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.

Why did Lord Leggatt conclude that these tests are steadily losing their last vestiges of independent authority? The first limb of the test is not a source of difficulty and it is entirely consistent with the requirement that 'clear words' be used if liability in negligence is to be effectively excluded. 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 and it is suggested that it is these principles that are the object of Lord Leggatt's concern, a point which can be demonstrated by the way in which the courts have approached these two principles in the past. The difficulty created by these two principles is that they rest on the dubious assumption that parties do not intend to use general words such as 'loss howsoever caused' to
p. 419 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 was not the approach taken by the courts in the immediate aftermath of the decision in *Canada Steamship*. 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 basic flaw in the *Canada Steamship* principles 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* v. *Rambler Motors (AMC) Ltd* [1972] 2 QB 71, 80 '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 influence of the *Canada Steamship* rules or principles has, however, gradually waned over time as the courts have emphasized that their paramount task is to give effect to the intention of the parties. This is perhaps best expressed in the judgment of Lord Bingham in *HIH Casualty and General Insurance Ltd* v. *Chase Manhattan Bank* [2003] UKHL 6, [2003] 2 Lloyd's Rep 61, [11] when he stated:

> 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.

The word 'ordinarily' is important here. We are not dealing with rules of law which must be rigidly applied. As the Court of Appeal observed in *Mir Steel UK Ltd* v. *Morris* [2012] EWCA Civ 1397, [2013] 2 All ER (Comm) 54, [35] the *Canada Steamship* principles 'should not be applied mechanistically and ought to be regarded as no more than guidelines'. In particular, they do not provide an 'automatic solution' to a particular case. Thus, where it is clear that the parties have used general words such as 'any claim' to encompass a claim brought in negligence, then effect must be given to their intention and the *Canada Steamship* guidelines should not be applied in such a way as to frustrate that intention.

p. 420 ↵ The latter point is illustrated by the decision of the Court of Appeal in *Greenwich Millennium Village Ltd* v. *Essex Services Group plc* [2014] EWCA Civ 960, [2014] 1 WLR 3517, where a party who had failed to detect a defect in work done by its contracting party was held to be entitled to claim an indemnity from that party. This was so notwithstanding the fact that the party claiming the indemnity had been negligent in the discharge of its duty to its contracting party. But, as between the parties to the contract containing the indemnity clause, the negligence of the party claiming the indemnity had been 'passive' (that is to say, it had failed to notice the defect) whereas the negligence of the party from whom the indemnity was claimed had been 'active' (that is to say it was its actions which had caused the loss in respect of which the claim had been brought). This being the case, the claimant was held to be entitled to bring a claim under the indemnity notwithstanding the lack of an express reference in the clause to 'negligence'. The construction adopted was held to be consistent with the intention of the parties in that it enabled liability to flow down the chain of contracts until it rested with the party whose active negligence had been responsible for the losses that had been suffered. However, had the negligence of the party claiming the indemnity been 'active', a court would have been less likely to conclude that it was effective to encompass negligence. The latter point was made clear by the Court of Appeal in *Persimmon Homes Ltd* v. *Ove Arup & Partners Ltd* [2017] EWCA Civ 373, [2017] BLR 417, [56], where Jackson LJ stated that the *Canada Steamship* guidelines were now 'more relevant' to indemnity clauses than to exclusion clauses on the basis that 'it is one thing to agree that A is not liable to B for the consequences of A's negligence' but it is 'quite another thing to agree that B must compensate A for the consequences of A's own negligence'.

However, it is likely that the authority of the *Canada Steamship* principles will gradually reduce in significance and be replaced by Lord Leggatt's principle in *Triple Point Technology Inc* v. *PTT Public Co Ltd* that a party is 'unlikely to have agreed to give up a valuable right that it would otherwise have had without clear words' (for an application of this approach see *PA(GI) Ltd* v. *Cigna Insurance Services (Europe) Ltd* [2023] EWHC 1360 (Comm), [40]). It is therefore suggested that Lord Leggatt was correct to state that the *Canada Steamship* principles should be discarded and replaced by a principle that requires that clear words be used if liability in negligence is to be effectively excluded. On this basis, where the clause expressly excludes liability in 'negligence' then, subject to the operation of the Unfair Contract Terms Act 1977 (on which see 13.3), effect

should be given to the clause. But there is no formal need to make use of the word 'negligence' given that liability in negligence can be excluded even if the word 'negligence' is nowhere to be found in the relevant clause (although prudence would suggest that, where the intention is to exclude liability in negligence, the safest course is to use the word 'negligence' expressly). Thus the use of words such as loss 'howsoever caused' or 'howsoever arising' should be effective to exclude liability in negligence where this is consistent with the objective intention of the parties derived from the words of the contract and its factual matrix.

13.2.2 Fundamental Breach

A classic illustration of the traditional, restrictive approach to the interpretation of exclusion and limitation clauses, although not directly referred to by Lord Leggatt in *Triple Point*, is the doctrine of fundamental breach which 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
p. 421 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:

> [W]hen 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 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:

> [I]t 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'.

It is therefore clear that fundamental breach no longer exists as a rule of law and, in so far as it may be said to reflect the approach which the courts take towards the interpretation of exclusion clauses, it is now probably best explained by reference to the 'clear words' rule. Thus in *Mott Macdonald Ltd* v. *Trant Engineering Ltd* [2021]
p. 422 EWHC 754 (TCC), [2021] BLR 440 ↵ it was held that an exclusion clause in a contract encompassed breaches of contract that were 'fundamental, deliberate, or wilful' because of the clear terms in which the clause had been drafted. In so concluding Judge Eyre QC confirmed (at [64]) that exclusion clauses, including those purporting to exclude or limit liability for deliberate and repudiatory breaches of contract, are to be construed by reference to 'the normal principles of contractual construction without the imposition of a presumption [against the clause extending to such breaches] and without requiring any particular form of words or level of language to achieve the effect of excluding liability'. However, he also added that these normal principles of contractual interpretation include the need for the use of clear words as he continued by observing (at [65]) that in cases of fundamental breach 'it will be inherently less likely than otherwise that a clause was intended to operate to exclude liability unless it is clear from the language when properly interpreted in context that it has that effect'. In this way the old rules or presumptions in relation to fundamental breach can be seen to have been subsumed within the wider 'clear words' rule, as set out by Lord Leggatt in *Triple Point*, and so it can be expected that the old learning on fundamental breach can be quietly laid to rest now that its work is done by the 'clear words' rule.

13.2.3 Limitation Clauses

A third area which has given rise to some difficulty is the approach that the courts should take towards the interpretation of 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.

p. 423

13.2.4 Indirect or Consequential Loss

A final point relating to the interpretation of exclusion and limitation clause relates to the meaning of the phrase 'indirect or consequential loss'. As has been noted (13.1), 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 23.8.1). 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 23.8.1), 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:

> [W]e 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.

p. 424

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, see 23.8.1). 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 *Star Polaris LLC* v. *HHIC-PHIL Inc* [2016] EWHC 2941 (Comm), [2017] 1 Lloyd's Rep 203, Sir Jeremy Cooke held that arbitrators had been entitled to conclude that the word 'consequential' was used by the parties in its cause-and-effect sense and not in the sense just outlined. Thus the equation of consequential losses with the second limb of *Hadley* v. *Baxendale* would appear not to be an inevitable one so that a court may be able to depart from it where it is established on the evidence that the parties did not

intend to use the phrase in this sense and they can point to terms in the contract which can only be consistent with the term being given a wider meaning. Further, 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.

13.3 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. Further changes were made to the Act by the Consumer Rights Act 2015, which now regulates exclusion and limitation clauses contained in contracts between traders and consumers so that the Unfair Contract Terms Act no longer regulates such terms. 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
p. 425 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 17.6) 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. 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.

13.3.1 Section 1

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

1 Scope of Part I

(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, 3 and 7 is subject to the exceptions made by Schedule 1.

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

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

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

and references to liability are to be read accordingly 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.

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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, see 13.4). 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 (13.3.9).

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 (13.3.13).

13.3.2 Section 2

> ### Avoidance of liability for negligence, breach of contract, etc
>
> **2 Negligence liability**
>
> (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.
>
> p. 427 (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.
>
> (4) This section does not apply to—
>
> (a) a term in a consumer contract, or
>
> (b) a notice to the extent that it is a consumer notice, (but see the provision made about such contracts and notices in sections 62 and 65 of the Consumer Rights Act 2015).

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 (13.3.9). 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 section 1(3), discussed earlier). Second, 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. Third, 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 (see 13.4).

Fourth, 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 (13.3.9). Fifth, 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 (13.3.7). 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*.

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13.3.3 Section 3

> **3 Liability arising in contract**
>
> (1) This section applies as between contracting parties where one of them deals 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.
>
> (3) This section does not apply to a term in a consumer contract (but see the provision made about such contracts in section 62 of the Consumer Rights Act 2015).

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 contracts where one party '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 Court of Appeal in *African Export-Import Bank* v. *Shebah Exploration & Production Co Ltd* [2017] EWCA Civ 845, [2017] BLR 469 held that there are four components of a claim that the requirements of section 3(1) have been satisfied (and the onus of proof is upon the party who alleges that the requirements of the subsection have been satisfied). The first is that the term must be written and the second is that the term must be a term of business. Third, the term must be part of the other party's standard terms of business and, finally, the parties must deal on those written standard terms.

The meaning of 'standard' was explored by Judge Stannard in *Chester Grosvenor Hotel Co Ltd* v. *Alfred McAlpine Management Ltd* (1991) 56 Build LR 115, 131 when he stated that:

> 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.

p. 429 ↵ In *African Export-Import Bank* v. *Shebah Exploration & Production Co Ltd* (earlier) the Court of Appeal affirmed that 'standard' requires a demonstration that the party putting forward the terms 'habitually uses these terms of business'. It does not suffice for this purpose to show that the terms are sometimes used; it is necessary to go further and demonstrate that they are invariably or usually used.

The meaning of 'deals' was considered by the Court of Appeal in *St Albans City and District Council* v. *International Computers Ltd* [1996] 4 All ER 481. 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 (at p. 491) on the ground that 'deals' means 'makes a deal' irrespective of any negotiations that may have preceded it. All that is required is for a party to enter into the contract on the other party's standard 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). The Court of Appeal in *African Export-Import Bank* v. *Shebah Exploration & Production Co Ltd* (earlier) held that it was relevant in this connection to ask whether there 'have been more than insubstantial variations to the terms which may otherwise have been habitually used by the other party to the transaction'. Thus section 3 is most likely to apply in the case where the defendant's standard terms have remained 'effectively untouched' (*Pinewood Technologies Asia Pacific Ltd v Pinewood Technologies plc* [2023] EWHC 2506 (TCC), [49]). If there have been substantive variations to the standard terms it is unlikely to be the case that the party attempting to invoke section 3 will have discharged the burden on it to show that the contract has been made on the other's written standard terms of business. There is also no requirement that the negotiations relate to the exclusion clause in the contract. So in the case where the negotiations have resulted in changes to some terms of the contract but not to the exclusion or limitation clause, section 3 will not be applicable because in such a case the contract has not been concluded on the defendant's standard terms of business (*African Export-Import Bank* v. *Shebah Exploration & Production Co Ltd,* above, [36]).

The meaning of 'other's' was considered by Judge Bowsher QC in *British Fermentation Products Ltd* v. *Compair Reavell Ltd* [1999] BLR 352. 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.]

p. 430 ↵ 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 (13.3.7).

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 12.3.5) 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):

> p. 431 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.

p. 432 ↵ 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]).

13.3.4 Section 6

> **Liability arising from sale or supply of goods**
>
> **6 Sale and hire-purchase**
>
> (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.
>
> (1A) 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 a contract term except 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.
>
> (5) This section does not apply to a consumer contract (but see the provision made about such contracts in section 31 of the Consumer Rights Act 2015).

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 10.2) and contracts of hire-purchase (sections 8–12 of the Supply of Goods (Implied Terms) Act 1973). 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,
p. 433 ↵ both of which are inevitably void). 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 10.2).

13.3.5 Section 7

> **7 Miscellaneous contracts under which goods pass**
>
> (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.
>
> (1A) 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 such a term except 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,
>
> 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.
>
> (4A) This section does not apply to a consumer contract (but see the provision made about such contracts in section 31 of the Consumer Rights Act 2015).

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. Liability can only be excluded to the extent that it is reasonable to do so. The requirement of reasonableness is discussed later in this section (13.3.7).

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13.3.6 Section 10

> **10 Evasion by means of secondary contract**
>
> 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* (35th edn, Sweet & Maxwell, 2023), para 18-156 (footnotes omitted) 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 a person purports to affect the rights of that person as 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 s. 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).

13.3.7 Section 11

Explanatory provisions

11 The 'reasonableness' test

(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
p. 435 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, 6(1A), 7(1A), 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 (13.3.14). 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 (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).

p. 436 ↵ In deciding whether or not a particular clause is reasonable, the courts have regard to a range of factors. The reasonableness of a particular exclusion or limitation clause is ‘a fact-sensitive issue’ which is generally not suitable for summary determination but should be resolved after a trial at which the evidence can be assessed by the judge (*Last Bus Ltd (t/a Dublin Coach) v Dawson Group Bus and Coach Ltd* [2023] EWCA Civ 1297, [53]). Judges have a considerable degree of flexibility 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, see 13.4, and *Cleaver* v. *Schyde Investments Ltd* [2011] EWCA Civ 929, [2011] 2 P & CR 221), 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] EWCA Civ 317, [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] EWCA Civ 317, [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.

The meaning of the clause therefore has a direct bearing on the likelihood of it passing the reasonableness test (see, for example, *University of Wales* v. *London College of Business Ltd* [2015] EWHC 1280 (QB)). 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). This can sometimes produce the rather odd consequence that the party who is seeking to set aside the exclusion clause is the party arguing that the clause has a wide meaning (for the purpose of demonstrating that it is unreasonable), whereas the party relying on the clause maintains that it is narrower in scope so that it can more easily establish that the clause is reasonable.

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(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* [2001] EWCA Civ 317, [2001] All ER (Comm) 696 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. As Gross LJ observed in *Goodlife Foods Ltd* v. *Hall Fire Protection Ltd* [2018] EWCA Civ 1371, [2018] BLR 491, [103], 'at least in the case of commercial contracts between parties of broadly equal bargaining power, considerations of party autonomy and freedom of contract remain potent.' Coulson LJ made a similar point when he stated (at [93]) that 'the trend in the UCTA cases decided in recent years has been towards upholding terms freely agreed, particularly if the other party could have contracted elsewhere and has, or was warned to obtain, effective insurance cover'. However, the fact that the parties are of roughly equal bargaining power and had access to legal advice does not guarantee that the clause will pass the reasonableness test. Exceptional cases can be found in which the courts have concluded that an exclusion or limitation clause in such a contract is unreasonable (see, for example, *First Tower Trustees Ltd* v. *CDS (Superstores International) Ltd* [2018] EWCA Civ 1396, [2019] 1 WLR 637, discussed in more detail at 17.6).

When considering whether or not contracting parties are of equal bargaining power, a court should not confine itself to the question whether there is equality of bargaining power in relation to the price to be paid for contractual performance. It is important to have regard to the equality of bargaining power as it relates to all the terms of the contract, including the exclusion clause. Thus the Court of Appeal has held that there was no equality of bargaining power in a case where the defendant might have been willing to negotiate on price
p. 438 but was not willing to accept any change to its standard exclusion clause and all other suppliers ↵ in the market had adopted the same approach (*Last Bus Ltd (t/a Dublin Coach)* v. *Dawson Group Bus and Coach Ltd* [2023] EWCA Civ 1297, [49]).

(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. However, there is a limit to the extent to which a court should have regard to hypothetical events. In *FG Wilson (Engineering) Ltd* v. *John Holt & Co (Liverpool) Ltd* [2012] EWHC 2477 (Comm), [2012] BLR 468, [96] Popplewell J stated that the court should do so 'only to the extent that they would have been contemplated by the parties at the time of contracting as realistic and not unlikely'. In particular, 'the court should not be too ready to focus on remote possibilities or to accept arguments that a clause fails the test by reference to relatively uncommon or unlikely situations.'

The fact that a court may have regard to a range of realistic hypothetical events when deciding whether or not a clause is reasonable 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 realistic 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). 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 (except where the term attempts, contrary to section 2(1), to exclude liability for death or personal injury caused by negligence, where the courts have in effect deleted the invalid attempt to exclude liability and proceeded to assess the reasonableness of the remaining parts of the clause: *Goodlife Foods Ltd* v. *Hall Fire Protection Ltd* [2017] EWHC 767 (TCC), [2017] BLR 389). 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).

(vi) 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. If the loss in respect of which the claim has been brought is one which the court would expect the claimant to be insured against in any event, a court may

be more inclined to conclude that it was reasonable for the defendant to exclude liability in respect of that loss so that the claimant's redress is to claim on its insurance policy rather than seek redress from the defendant, particularly in the case where the defendant has offered the claimant the option of additional insurance cover in return for the offer of increased liability (*Goodlife Foods Ltd* v. *Hall Fire Protection Ltd* [2018] EWCA Civ 1371, [2018] BLR 491).

(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 (13.4) 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
> p. 440 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 13.4).

(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
p. 441 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, the defendants were insured, and 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, see 13.4) 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). 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 (13.3.14). 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.

13.3.8 Section 13

> **13 Varieties of exemption clause**
>
> (1) To the extent that this Part of this Act prevents the exclusion or restriction of any liability it also prevents—
>
> (a) making the liability or its enforcement subject to restrictive or onerous conditions;
>
> (b) excluding or restricting any right or remedy in respect of the liability, or subjecting a person to any prejudice in consequence of his pursuing any such right or remedy;
>
> (c) excluding or restricting rules of evidence or procedure;
>
> and (to that extent) sections 2 and 6 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.

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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 6–7 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) (13.3.3).

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 6–7 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* (35th edn, Sweet & Maxwell, 2023, para 18-081, footnotes omitted):

> 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. A simple example of the latter may be found in the situation where a decorator agrees to paint the outside woodwork of a house except the garage doors: in the view of the Law Commissions, this would be 'a convenient way of defining the obligation' and should not be assimilated to an exemption clause. Further examples could be found where a seller of kitchen utensils expressly states that they are suitable to be used only on electric cookers and not with gas, or a surveyor stipulates that he undertakes to carry out a valuation of the property and not a full structural survey. However, in other cases there may be more 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 (see 13.4).

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13.3.9 Section 14

> **14 Interpretation of Part I**
>
> In this Part of this Act—
>
> 'business' includes a profession and the activities of any government department or local or public authority;
>
> 'consumer contract' has the same meaning as in the Consumer Rights Act 2015 (see section 61);
>
> 'consumer notice' has the same meaning as in the Consumer Rights Act 2015 (see section 61);
>
> '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. It is here also that

the definitions of those consumer contracts removed from the scope of the Act are to be found.

13.3.10 Section 26

> **Part III Provisions Applying to the Whole of United Kingdom Miscellaneous**
>
> **26 International supply contracts**
>
> (1) The limits imposed by this Act on the extent to which a person may exclude or restrict liability by reference to a contract term do not apply to liability arising under such a contract as is described in subsection (3) below.
>
> (2) The terms of such a contract are not subject to any requirement of reasonableness under section 3: 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.
>
> p. 444 (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. 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' in section 26(3)(b) 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 reference in section 26(4)(b) to 'the acts constituting the offer and acceptance' have been held to refer to the 'totality of the acts which constitute the offer and acceptance, including the making and receiving of each' so that, where the offer and acceptance were each sent by fax from different countries, the offer and acceptance had been done in the territories of different States (*Air Transworld Ltd* v. *Bombardier Inc* [2012] EWHC 243 (Comm), [2012] 1 Lloyd's Rep 349, [82]). 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).

13.3.11 Section 27

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27 Choice of law clauses

(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—

(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.

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. This is, however, subject to the limitation that the controls contained in the Act cannot be evaded where 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 (section 27(2)).

13.3.12 Section 29

> **29 Saving for other relevant legislation**
>
> (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 … 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.
>
> (3) In this section—
>
> 'competent authority' means any court, arbitrator or arbiter, government department or public authority;
>
> p. 446 ↵ '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.

13.3.13 Schedule 1

Schedule 1

Scope of Sections 2 to 3 and 7

1. Sections 2 to 3 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—

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

   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.

   (f) anything that is governed by Article 6 of Regulation (EU) No 181/2011 of the European Parliament and of the Council of 16 February 2011 concerning the rights of passengers in bus and coach transport and amending Regulation (EC) No 2006/2004.

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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 3 and 7 do not extend to any such contract.

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) and 3 do not 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, 3, and 7 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.

13.3.14 Schedule 2

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(1A), 7(1A) 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);

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(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.

13.4 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.'

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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', which concerned the application of the reasonableness test to the term in dispute.]

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
p. 450 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 [the strength of the bargaining position of the parties, whether the buyer received an inducement to agree to the terms or had an alternative source of supply which did not contain such a term and whether the buyer knew or ought reasonably to have known of the existence and extent of the term]. 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 inter-related. 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,
p. 451 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 that section 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'. 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, 13.3.7).

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 connection 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 connection 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.'

p. 452 ↵ 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-
p. 453 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'.

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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
p. 455 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.'
>
> ...
>
> 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, 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 mis-recollected 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'. ...

> p. 456 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
p. 457 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, 13.5). 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. There is no clear-cut solution to the latter problem. Where the clause is held genuinely to reflect and give effect to the rights and duties which the parties have assumed, it is likely that the Act will not be engaged (*Titan Steel Wheels Ltd* v. *Royal Bank of Scotland plc* [2010] EWHC 211 (Comm), [2010] 2 Lloyd's Rep 92, [104]). On the other hand, where the clause attempts 'retrospectively to alter the character of what has gone before' or 'to rewrite history or parts company with reality' in relation to the assumption of responsibility by the defendant, then the clause is more likely to fall within the scope of section 13 (*Avrora Fine Arts Investment Ltd* v. *Christie, Manson & Woods* [2012] EWHC 2198 (Ch), [2012] PNLR 35, [144]).

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. 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
> p. 458 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.

13.5 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
p. 459 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,
p. 460 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.

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> ↵ 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 at 13.4) 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.

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Notes

[1] This means literally that to a willing person it is not a wrong and its effect is to deny a claim to someone who willing accept the risk of loss.

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