Part II

The Content of a Contract

8 What is a Term?

Having considered what the law recognises as a valid, enforceable contract and who is bound by that contract, we shall now consider the contents of a contract. This section is divided into four chapters. In this chapter we shall consider what constitutes a term of the contract; in Chapter 9 we shall discuss the sources of contractual terms; in Chapter 10 we shall consider the classification of contractual terms; and in Chapter 11 we shall analyse a particular type of contractual term, the exclusion or limitation clause.

8.1 What is a Term?

A contract consists of a number of terms. However not everything that is said or written during the course of negotiations constitutes a term of the contract. An example will illustrate the point. Suppose that I agree to sell my bicycle to my neighbour. During the course of negotiations he may ask me many things about it; its age, its size, how often it has been serviced, whether it has gears and, if so, how many, and so on. But the conclusion of the contract may consist simply of my statement 'I will sell you the bicycle for £200' and his statement 'I accept'. It is, however, highly unlikely that these two statements would be held to constitute the entirety of the contract. It is equally unlikely that all my answers to my neighbour's questions would be regarded as terms of the contract. My answers could, in fact, be classified in one of three ways.

The first is that some answers could be treated as mere statements of opinion or 'mere puffs' and will have no legal effect (for example a statement that 'you will never regret buying a bicycle from me'; see further 13.3). The principal distinction however, is between the second and the third categories; that is, between a term and a mere representation (note that in some cases the distinction is drawn between 'warranties' and 'mere representations', but this terminology will not be used here because it leads to confusion when, in Chapter 10, we seek to distinguish between a condition and a warranty (both of which are terms of a contract)). The distinction between a term and a mere representation is important because, if a statement is held to be a term of the contract, a failure to comply with it will be a breach of contract, entitling the innocent party

to a remedy for breach of contract. On the other hand, if the statement is held to be a mere representation, the innocent party cannot claim that there has been a breach of contract because the statement was not a term of the contract. His remedy, if any, is to seek to have the contract set aside or claim damages for misrepresentation (see further, Chapter 13).

Whether a statement is a contractual term or a mere representation depends, ultimately, on the intention with which the statement was made. In considering the intention with which a particular statement was made, the courts have, once again, adopted an objective approach to intention. The cases have established some principles (see 8.2–8.4) to guide the court in deciding whether a statement is a term or a mere representation. No one principle is decisive; in every case the court must assess the relative importance of each principle (see Lord Moulton in *Heilbut, Symons & Co* v. *Buckleton* [1913] AC 30, 50–51).

8.2 Verification

A statement is unlikely to be a term of the contract if the maker of the statement asks the other party to verify its truth. In *Ecay* v. *Godfrey* (1947) 80 Ll LR 286, a seller of a boat stated that the boat was sound but advised the buyer to have it surveyed. His statement was held to be a mere representation. On the other hand, in *Schawel* v. *Reade* [1913] 2 IR 64, the claimant, while examining a horse with a view to buying it for stud purposes, was told by the defendant: 'You need not look for anything; the horse is perfectly sound. If there was anything the matter with this horse I should tell you'. In reliance upon this statement the claimant bought the horse without examining it. It was subsequently discovered that the horse was totally unfit for stud purposes and it was held that the defendant's statement was a term of the contract (contrast *Hopkins* v. *Tanqueray* (1854) 15 CB 130).

8.3 Importance

A statement is likely to be a term of the contract where it is of such importance to the person to whom it is made that, had it not been made, he would not have entered into the contract. In *Couchman* v. *Hill* [1947] KB 554, a heifer was put up for sale at an auction but no warranty was given as to its condition. The claimant asked the defendant whether the heifer was in calf and stated that he was not interested in purchasing it if it was. He was told that it was not in calf. Approximately seven weeks after the

purchase the heifer suffered a miscarriage and died. The claimant brought an action for breach of contract. The statement that the heifer was not in calf was held to be a term of the contract because of the importance attached to it by the claimant (contrast *Oscar Chess Ltd* v. *Williams* [1957] 1 WLR 370, discussed at 8.4).

8.4 Special Knowledge

If the maker of a statement has some special knowledge or skill compared to the other party, the statement may be held to be a contractual term. On the other hand, if the parties' degrees of knowledge are equal or if the person to whom the statement is made has the greater knowledge, the statement may be held to be a mere representation. These propositions can be illustrated by reference to the following two cases.

The first is *Oscar Chess Ltd* v. *Williams* (above), in which the defendant sold a car to the claimants for £290. The car was described as a 1948 Morris 10; in fact it was a 1939 model (which was worth only £175). The defendant had obtained the information that the car was a 1948 model in good faith from the car log book, but the log book was subsequently discovered to be a forgery. It was held that the defendant's statement as to the age of the car was not a term of the contract but a mere representation. The claimants, who were car dealers, were in at least as good a position as the defendant to know the true age of the car. On the other hand, in *Dick Bentley Productions Ltd* v. *Harold Smith (Motors) Ltd* [1965] 1 WLR 623, the claimant asked the defendants, who were car dealers, to find him a 'well vetted' Bentley car. The defendants found a car which they sold to the claimant and which they stated had done only 20,000 miles since a replacement engine had been fitted. It had in fact done 100,000 miles. It was held that the defendants' statement as to the car mileage was a term of the contract; the defendants, being car dealers, were in a better position than the claimant to know whether their statement was true.

8.5 The Consequences of the Distinction Between a Term and a Mere Representation

Although the distinction between a term and a mere representation is important, it is not quite as fundamental as it used to be. At the beginning of this century it was important because damages were only available for misrepresentation in a very narrow range of circumstances. But now, both at common law and under the Misrepresentation Act 1967,

damages are available for misrepresentation in a much wider range of circumstances (see 13.9). The distinction is now primarily relevant to the *amount* of damages recoverable rather than to whether damages are recoverable at all (although there do remain cases in which damages are not recoverable for misrepresentation, see 13.9). If the statement is held to be a term, breach will generally entitle the innocent party to recover damages which will have the effect of putting him in the position which he would have been in had the contract been performed (called his 'expectation interest'), whereas if it is a representation, damages will generally be assessed on the basis of the extent to which the representee has incurred loss through reliance on the misrepresentation (the 'reliance interest') (see further Chapter 20).

The distinction between a term and a representation is also relevant to the ability to set aside the contract. In the case of misrepresentation, the representee is always, in principle, entitled to set aside the contract (see 13.8), while in the case of a term the innocent party can only set aside the contract where the term which has been broken is a condition (see 10.3) or is an 'innominate term' and the consequences of the breach have been sufficiently serious (see 10.5). The meaning of 'set aside' also differs between the two contexts (see further 13.8). In the case where the contract is set aside on the ground of misrepresentation, the contract is set aside both retrospectively and prospectively so that the aim of setting the contract aside is to restore both parties to their pre-contractual position. But in the case where a contract is set aside for breach, it is set aside prospectively only and the setting aside does not have retrospective consequences (see 19.7).

8.6 Can a Representation be Incorporated into a Contract as a Term?

This may seem a strange question to ask given that we have spent a chapter arguing that the two are separate and distinct. The issue can be illustrated by reference to the case of *Pennsylvania Shipping Co* v. *Compagnie Nationale de Navigation* [1936] 2 All ER 1167. A tanker was chartered from the defendants by the claimants. Prior to the conclusion of the contract, the defendants provided the claimants with incorrect information about the heating of the ship. This information was subsequently incorporated into the contract. When the claimants discovered the true position, they sought, *inter alia*, to have the contract set aside on the ground of misrepresentation. Branson J held that the representation became 'merged in the higher contractual right' and that there was there-

fore no need to set aside the contract on the ground of misrepresentation; the claimants' claim was for breach of contract (contrast *Compagnie Française des Chemin de Fer Paris-Orleans* v. *Leeston Shipping Co* (1919) 1 Ll LR 235). However section 1(a) of the Misrepresentation Act 1967 now provides that a representee who has entered into a contract after a misrepresentation has been made to him may rescind the contract for misrepresentation, even though the misrepresentation is subsequently incorporated into the contract, provided that he would otherwise be entitled to rescind the contract. This may be of very great significance where the representee is unable to rescind the contract for breach because, for example, the term which has been broken is a warranty (see further 10.3). In such a case, provided the relevant conditions for rescission for misrepresentation are satisfied (on which see 13.8), he may nevertheless be entitled to rescind for misrepresentation.

Summary

1. A contract consists of a number of terms.
2. A term must be distinguished from a statement of opinion or 'mere puff' (which has no legal effect) and a mere representation (which generates a claim for misrepresentation).
3. The question whether a statement is a term or a mere representation depends upon the intention with which the statement was made. Factors to which the court will have regard in deciding this issue include whether the maker of the statement advised the other party to verify the truth of his statement, the importance of the statement and the respective states of knowledge of the parties.
4. In certain circumstances the term/representation dichotomy may be crucial to the recoverability of damages but it is more likely that it will be relevant to the amount of damages recoverable. Where a term of the contract has been broken, damages will generally protect the promisee's expectation interest but, in the case of a misrepresentation, damages will only protect the misrepresentee's reliance interest.
5. A representee who has entered into a contract after a misrepresentation has been made to him may rescind the contract for misrepresentation, even though the misrepresentation is subsequently incorporated into the contract, provided that he would otherwise be entitled to rescind for misrepresentation.

Exercises

1. Why do lawyers distinguish between a term and a mere representation?
2. Distinguish between a term and a mere representation. What are the consequences of this distinction?
3. John, a specialist race-horse trainer, wished to buy a horse from Fred, who was a farmer who had little knowledge of horses. John believed that the horse was a potential champion and, during the course of negotiations, he asked Fred if he could inspect the horse. Fred said there was really no need as his stable-boy had

assured him that the horse would make a 'brilliant race-horse'. In reliance on Fred's statement, John bought the horse. When the horse was delivered to John, he found it had a serious leg injury which made it useless as a race-horse. John wishes to know whether his remedy lies for breach of contract or for misrepresentation. Advise him.

4 What is the effect of s.1(a) of the Misrepresentation Act 1967?

9 The Sources of Contractual Terms

9.1 Introduction

There are two principal sources of contractual terms: express terms and implied terms. Express terms are the terms which are agreed specifically by the contracting parties and implied terms are those terms which are not specifically agreed by the contracting parties but which are implied into the contract by the courts or by Parliament. We shall deal with implied terms at 9.8. Here we shall focus our attention on express terms.

Express terms may be agreed orally or in writing. Where the contract is made orally the ascertainment of the contractual terms may involve difficult questions of fact, but the task of a judge is simply to decide exactly what was said by each of the parties. More particular difficulties arise in the case of written contracts. Three such difficulties will be dealt with here. The first and fundamental issue is whether the court can go beyond the written agreement in an attempt to discover the existence of additional terms to the contract (9.2). The second is whether a person is necessarily bound by the terms of a contract which he has signed (9.3). The third and final issue is whether written terms can be incorporated into a contract, either by notice (9.4) or by a course of dealing (9.5). Once we have discussed these issues we shall consider the approach which the courts adopt towards the interpretation of contracts (9.6).

9.2 The Parol Evidence Rule

Once the contracting parties have elected to enshrine their contract in a written document, the courts have held that, as a general rule, the parties cannot adduce extrinsic evidence to add to, vary or contradict the written document; the document is the sole repository of the terms of the contract (*Jacobs* v. *Batavia & General Plantations Trust Ltd* [1924] 1 Ch 287). This rule has been called the 'parol evidence rule'. The purpose behind this rule is said to be the promotion of certainty; that is to say, once the parties have gone to the trouble of drawing up a written document, one party should not be able to allege with impunity that there were, in fact, other terms which were, for some reason, not incorporated into the final written document.

If this rule were to be applied rigidly to all cases there is no doubt that it would produce considerable injustice. For example, the written document may have been procured by fraud and so one party would wish to lead extrinsic evidence to prove that fraud. So it is no surprise to find that the parol evidence rule is not an absolute rule, but is the subject of numerous exceptions. We will now consider the scope of these exceptions and then consider their implications for the status of the rule.

The first exception is that the rule does not apply where the written document was not intended to contain the whole of the agreement (*Allen* v. *Pink* (1838) 4 M & W 140). As Wedderburn has remarked (1959) this exception reduces the rule to 'no more than a self-evident tautology . . . when the writing is the whole contract, the parties are bound by it and parol evidence is excluded; when it is not, evidence of the other terms must be admitted'.

The Law Commission in its report (No. 154 Cmnd 9700 (1986)) agreed with this observation, adding that the parol evidence rule is 'no more than a circular statement'. On this view the parol evidence rule does not give rise to injustice because it will never prevent a party from leading evidence of terms which were intended to be part of the contract. On the other hand it must be remembered that the courts will presume that a document which looks like the contract is the whole contract. However, this presumption is rebuttable, and the presumption operates with less strength today than in former times, and it is therefore highly unlikely that the parol evidence rule will preclude a party from leading evidence of terms which were intended to be part of the contract.

Parol evidence is also admissible to prove terms which must be implied into the agreement (*Gillespie Bros & Co* v. *Cheney, Eggar & Co* [1896] 2 QB 59); to prove a custom which must be implied into the contract (*Hutton* v. *Warren* (1836) 1 M & W 466); to show that the contract is invalid on the ground of misrepresentation, mistake, fraud or *non est factum* (on which see 9.3 and *Campbell Discount Co* v. *Gall* [1961] 1 QB 431); to show that the document should be rectified; to show that the contract has not yet come into operation or that it has ceased to operate (*Pym* v. *Campbell* (1856) 6 E & B 370); and to prove the existence of a collateral agreement (*Mann* v. *Nunn* (1874) 30 LT 526). The latter exception is of particular significance because in one case extrinsic evidence was actually used to *contradict* the terms of the written agreement. In *City and Westminster Properties (1934) Ltd* v. *Mudd* [1959] Ch 129, a lease entered into by the parties contained a covenant which stated that the tenant could use the premises for business purposes only. The tenant had been induced to sign the lease by an oral assurance given by the lessors' agent that the lessors would not raise any objection to the tenant continuing his

practice of residing in the premises. In an action by the lessors to forfeit the lease on the ground that the tenant was using the premises for residential purposes, it was held that evidence of the assurance given by the lessors' agent was admissible to prove the existence of a collateral agreement, despite the fact that it contradicted the express terms of the written lease. This case has been subjected to some criticism and it does appear to be inconsistent with earlier cases such as *Angell* v. *Duke* (1875) 32 LT 320 and *Henderson* v. *Arthur* [1907] 1 KB 10. However, if the collateral agreement is truly a separate agreement, then there is no reason why it should not be contrary to the terms of the written agreement. That said, it must be conceded that the effect of the decision is largely to undermine the parol evidence rule.

The parol evidence rule has been subjected to considerable criticism. The exceptions are so wide that they subvert the purpose of the rule in promoting certainty. Indeed, the width of the exceptions is such that it must now be doubted whether there is a 'rule' in English law that parol evidence is not admissible to add to, vary or contradict the written document. In the light of these criticisms the Law Commission provisionally recommended in 1976 (Working Paper No. 76) that the parol evidence rule be abolished but, in its more recent report (No. 154 Cmnd 9700), it concluded that no legislative action need be taken for two reasons. The first was that the rule did not preclude the courts from having recourse to extrinsic evidence where such a course was consistent with the intention of the parties. The second reason was that any legislative change would be more likely to confuse than clarify the law. Therefore the 'rule' remains in existence but it must be remembered that it is a rule which, because of the width of the exceptions, is unlikely to have significant effects in practice.

9.3 Bound by Your Signature?

Despite the existence of numerous exceptions to the parol evidence rule, English law does attach some importance to the sanctity of written documents and this can be seen in the general rule that a person is bound by a document which he signs, whether he reads it or not. This proposition can be derived from the case of *L'Estrange* v. *F Graucob Ltd* [1934] 2 KB 394. The claimant bought an automatic slot machine from the defendants. She signed an order form which contained a clause which excluded liability for all express and implied warranties. When the claimant discovered that the machine did not work she brought an action against the defendants for breach of an implied warranty that the machine was fit for

the purpose for which it was sold. Judgment was given for the defendants on the ground that they had excluded their liability by virtue of the exclusion clause which was incorporated into the contract by the claimant's signature, even though the exclusion clause was in 'regrettably small print' and had not been read by the claimant. Given the widespread use of contracts which rely heavily upon the use of small print, such a rule appears singularly unfortunate, especially in its application to consumers.

A significant limit appears to have been placed upon *L'Estrange* by the decision of the Court of Appeal in *Grogan* v. *Robin Meredith Plant Hire* [1996] CLC 1127. The claimant brought a claim for damages against the defendants arising out of an accident involving construction machinery which had been hired by the defendants to a-firm called Triact. The agreement between the defendants and Triact was made orally and no mention was made of any right of indemnity. At the end of the first and second week of the hire, Triact's site manager was asked to sign a time sheet which, towards the bottom stated 'All hire undertaken under CPA conditions. Copies available on request'. The CPA conditions included an indemnity clause which, the defendants argued, entitled them to claim an indemnity from Triact in respect of the damages which they had been required to pay to the claimant. They argued that the indemnity clause was incorporated into the contract by virtue of the signature contained on the time sheet. The status of the document which had been signed was irrelevant, they argued, because Triact was bound by the signature of its site manager. The Court of Appeal rejected this argument and held that the indemnity clause had not been incorporated into the contract. Auld LJ stated that it was 'too mechanistic' a proposition to state that the mere signature of a document which contains or incorporates by reference contractual terms has the effect of incorporating these terms into the contract. The court must consider whether the document which has been signed could be regarded as a contractual document having contractual effect or whether it was simply an administrative document designed to enable the parties to give effect to their prior agreement (on the present facts, by enabling the parties to agree what was due by one party to the other). In deciding whether the document purports to have contractual effect the court must consider, not only the nature and purpose of the document, but also the circumstances surrounding its use by the parties and their understanding of its purpose at the time. On the facts of *Grogan* the time sheet was held not to have contractual effect. The focus of the court was therefore on the nature of the document which had been signed. Where the document which has been signed is not one which would ordinarily have contractual effect, the signature of the party alleged to be bound is likely to add little. He is not entrapped by his

signature. But what of the case where the document is intended to have contractual effect, but the party seeking to enforce the terms of the document knows that the other party has not read or understood the terms of the document? This issue was not considered by the Court of Appeal in *Grogan* and so would appear to fall within the scope of *L'Estrange*. But there is modern Commonwealth authority which might be used to support a wider attack on *L'Estrange*. The Ontario Court of Appeal in *Tilden Rent-a-Car Co* v. *Clendenning* (1978) 83 DLR (3d) 400 adopted a more realistic view and recognised that many standard form printed contracts are signed without being read or understood. The court held that a signature could only be relied upon as evidence of genuine consent when it was reasonable for the party relying on the signed document to believe that the signer did assent to the onerous terms proposed. The English courts have not yet embraced such a broad principle, although *Grogan* might suggest that they are not very far away from it.

In the absence of an established common law principle which can attack clauses of the type used in *L'Estrange*, the focus of attention has largely shifted towards Parliament. The Unfair Contract Terms Act 1977 (see 11.9–11.15) places significant controls upon exclusion clauses of the type found in *L'Estrange*. The Unfair Terms in Consumer Contracts Regulations 1999 (see 17.6) will also have a role to play in the consumer context in regulating the use of unfair terms in the small print of contracts. Two of its provisons appear to be of relevance in this context. The first is paragraph 1(i) of Schedule 2 to the Regulations which states that a term which has the object or effect of 'irrevocably binding the consumer to terms with which he had no real opportunity of becoming acquainted before the conclusion of the contract' is indicatively unfair. This provision attacks the *L'Estrange* rule in the consumer context, not by challenging the effect of signature, but by regulating the term which seeks to incorporate the onerous terms into the contract. Its focus is upon the 'incorporation term' rather than the terms which it is sought to incorporate into the contract. The second provision is paragraph 1(b) of Schedule 2 which applies to terms which have the object or effect of

> 'inappropriately excluding or limiting the legal rights of the consumer *vis-à-vis* the seller or supplier . . . in the event of total or partial non-performance or inadequate performance by the seller or supplier of any of the contractual obligations.'

This time the focus is upon the terms which it sought to incorporate and, had *L'Estrange* been a consumer contract, then it seems clear that the

exclusion clause would have fallen within the scope of paragraph 1(b) and so would have been indicatively unfair.

Aside from the possible impact of the Unfair Contract Terms Act 1977 and the Unfair Terms in Consumer Contracts Regulations 1999, the rule in *L'Estrange* does not apply where the signature has been procured by fraud, misrepresentation or the defence of *non est factum* is made out. Fraud and misrepresentation will be dealt with in Chapter 13. Here we shall discuss the defence of *non est factum*.

The defence of *non est factum* is a defence of respectable antiquity in English law. It was originally applied to the case where an illiterate person signed a deed which had been read to him incorrectly by another person. In such a case the illiterate person was not bound by the deed; to put it in technical terms, he could plead *non est factum*, which means 'this is not my deed'. The effect of *non est factum* is to render the deed void so that a third party cannot obtain good title under it (see further on the issue of third party rights the discussion at 4.6). As the doctrine has developed, it has had to grapple with the problem that it is seeking to reconcile two competing policies. These policies are, firstly, the injustice of holding a person to a bargain to which he has not brought a consenting mind and the second is the necessity of holding a person to a document which he has signed, especially where innocent third parties rely to their detriment upon the validity of the signature.

These two competing policies can be seen at work in the important decision of the House of Lords in *Saunders* v. *Anglia Building Society* (also referred to as *Gallie* v. *Lee*) [1971] AC 1004. A widow of 78 made a will in which she left her house to her nephew. However the nephew wished to raise money immediately on the security of the home. The widow was prepared to help her nephew to raise the money provided that she was permitted to live in her home for the rest of her life rent free. The difficulty for the nephew was that he did not want to raise the loan in his own name because he was afraid that his wife would get her hands on the money. So he arranged that a friend of his should raise the money on the security of the house. The nephew arranged for the preparation of a document assigning the house to the friend for £3000. The widow did not read the document because her glasses were broken, but she signed it after the friend told her that it was a deed of gift to the nephew. The friend raised money on a mortgage with the respondent building society but he made no payment either to the building society, the nephew or the widow. The building society sought to recover possession of the property from the widow, who invoked the defence of *non est factum*. Here we have the clash of the competing policies which we noted above. On the one hand there is the injustice of holding the widow to an agreement to which

she had not brought a consenting mind, but on the other hand there is the need to protect the building society which had innocently relied to its detriment upon the widow's signature. The House of Lords gave greater weight to the second policy than the first and held that the defence of *non est factum* was not made out on the facts of the case. As Scott LJ stated in *Norwich and Peterborough Building Society* v. *Steed (No. 2)* [1993] QB 116, 125, the law almost invariably protects the innocent third party because 'the signer of the document has, by signing, enabled the fraud to be carried out, enabled the false documents to go into circulation'. It is the signer of the document who must therefore bear the consequences and to further that goal *non est factum* is kept within very narrow confines. Its scope can best be considered by asking ourselves three questions.

The first question is: to whom is the plea available? As originally conceived, the doctrine only applied to those who were unable to read. However in *Saunders* it was held that the doctrine was not confined to those who are blind or illiterate. It extends to those 'who are permanently or temporarily unable through no fault of their own to have without explanation any real understanding or purport of a particular document, whether that be from defective education, illness or innate incapacity'. Their Lordships did not say that the defence could never be available to a person of full capacity, but it would only be available to him in the most exceptional of cases and would not be available simply because he was too busy or too lazy to read the document.

The second question is: for what type of mistake is the defence available? Initially it was held that the defence was available if the mistake went to the heart of the transaction (*Foster* v. *MacKinnon* (1869) LR 4 CP 704). But in *Howatson* v. *Webb* [1907] 1 Ch 537 Warrington J drew a distinction between a mistake as to the 'character' of the document and a mistake as to its 'content', only the former being sufficient to support a plea of *non est factum*. However this distinction was rejected by the House of Lords in *Saunders* on the ground that it was 'arbitrary'. Instead it was held that the difference between the document as it was and as it was believed to be must be radical or substantial or fundamental. This test was not satisfied on the facts of *Saunders* because the widow wished to benefit her nephew by enabling him to raise money on the security of the house and the document which she signed was in fact intended to do this, although it was designed to do it by a different route, namely by assignment to the friend instead of by gift to the nephew.

The third and final question is: in what circumstances is a person precluded from relying on the defence? The principal circumstance in which the defence is not available arises where there is carelessness on the part

of the person who signs the document. In *United Dominions Trust Ltd* v. *Western* [1976] QB 513, the defendant signed a loan agreement with the claimant company in connection with the purchase of a car and he left it to the garage owner to fill in the details, including the price. The garage owner increased the price of the car and the claimant company paid over the money to the garage owner in good faith. The court held that the onus was on the defendant to show that, in allowing the form to be filled in by the garage owner, he had acted carefully. It was held that he had wholly failed to discharge that onus and therefore could not invoke the defence of *non est factum* (see also *Norwich and Peterborough Building Society* v. *Steed (No. 2)* [1993] QB 116, 128).

It is clear that English law has given considerable weight to the idea that a person should be able to rely on the signature of a contracting party. Such protection would be undermined by a wide defence of *non est factum* because it would render agreements void and thus detrimentally affect third party rights. However it should not be assumed that, where the defence of *non est factum* fails, the person who signs the document will therefore be left without a remedy. He may have a remedy in misrepresentation, fraud or undue influence (see *Avon Finance Co* v. *Bridger* [1985] 2 All ER 281). But the important point to note is that misrepresentation, fraud and undue influence only render the contract voidable and so greater protection is thereby afforded to third party rights.

9.4 Incorporation of Written Terms

Contracting parties may agree to incorporate a set of written terms into their contract. Three hurdles must be overcome before such terms can be incorporated. The first is that notice of the terms must be given at or before the time of concluding the contract. It is therefore crucial to determine the *precise* moment at which the contract was concluded. In *Olley* v. *Marlborough Court Ltd* [1949] 1 KB 532, a notice in the bedroom of a hotel, which purported to exempt the hotel proprietors from any liability for articles lost or stolen from the hotel, was held not to be incorporated into a contract with a guest, whose furs were stolen from her bedroom, because the notice was not seen by the guest until after the contract had been concluded at the hotel reception desk.

Secondly, the terms must be contained or referred to in a document which was intended to have contractual effect. It is a question of fact whether or not a document was intended to have contractual effect and the issue must be decided by reference to current commercial or con-

sumer practices. In *Chapleton* v. *Barry UDC* [1940] 1 KB 532, the claimant hired a deck chair from the defendants. On paying his money he was given a ticket, which, unknown to him, contained a number of conditions, including an exclusion clause. The claimant was injured when he sat in the deck chair and it gave way beneath him. He sued the defendants, who relied by way of defence on the exclusion clause contained in the ticket. It was held that they could not rely on the exclusion clause because it was contained in a mere receipt which was not intended to have contractual effect.

Thirdly, and finally, reasonable steps must be taken to bring the terms to the attention of the other party. In *Parker* v. *South Eastern Railway* (1877) 2 CPD 416, it was established that the test is whether the defendant took reasonable steps to bring the notice to the attention of the claimant, not whether the claimant actually read the notice. Thus, in *Thompson* v. *London, Midland and Scottish Railway Co Ltd* [1930] 1 KB 41, an exclusion clause contained in a railway time-table was held to be validly incorporated despite the fact that the claimant was illiterate and therefore unable to read the clause. The result may be different, however, where the party seeking to rely on the exclusion clause knows of the disability of the other party (*Richardson, Spence and Co Ltd* v. *Rowntree* [1894] AC 217).

What amounts to reasonable notice is a question which depends upon the facts and circumstances of the individual case. In *Thompson* the defendants were held to have taken reasonable steps to bring the exclusion clause to the attention of the claimant, even though it was contained on page 552 of the timetable and the timetable cost 1/5 of the price of the railway ticket. It is doubtful whether such a liberal view would be taken today (see, for example, *The Mikhail Lermontov* [1990] 1 Lloyd's Rep 579, 594). If the clause is not referred to on the front of the ticket (*Henderson* v. *Stevenson* (1875) LR 2 Sc & Div 470) or if the reference to the clause is obliterated (*Sugar* v. *London, Midland and Scottish Railway Co* [1941] 1 All ER 172) the clause is less likely to be incorporated into the contract. Similarly, the more unusual or unreasonable the exclusion clause, the greater the degree of the notice required by the courts. In *J Spurling Ltd* v. *Bradshaw* [1956] 1 WLR 461, Denning LJ said that some clauses would need to be printed in red ink on the face of the document with a red hand pointing to it before the notice could be held to be sufficient.

All of the 'incorporation' cases which we have considered so far are concerned with attempts to incorporate exclusion clauses into a contract. They generally evince a restrictive approach to incorporation, particularly

in cases such as *Spurling* v. *Bradshaw* (above) where Lord Denning enunciated his 'red hand rule'. It could be argued that such a restrictive approach is confined to exclusion clauses and, indeed, that, since the enactment of the Unfair Contract Terms Act 1977, which gives the courts considerable power to control exclusion clauses (see 11.9–11.15), there is little need for such a restrictive approach, even in the case of exclusion clauses. But the restrictive approach is very much alive and, further, it is not confined to exclusion clauses.

In *Interfoto Picture Library Ltd* v. *Stiletto Visual Programmes Ltd* [1989] QB 433 (see further Macdonald, 1988a) the defendants ordered photographic transparencies from the claimants, not having dealt with them before. The claimants duly sent them 47 transparencies, together with a delivery note which contained a number of conditions. Condition 2 stated that a holding fee of £5 per day was payable for every day the transparencies were kept in excess of fourteen days. The defendants put the transparencies to one side and forgot about them. They eventually returned them after approximately one month. The claimants then sent the defendants an invoice for £3783.50, which the defendants refused to pay. In an action by the claimants to recover the £3783.50, the Court of Appeal held that condition 2 was not incorporated into the contract because insufficient notice had been given to the defendants of its terms and that, in the absence of express provision in the contract, the claimants were only entitled to a restitutionary award of £3.50 per transparency per week. It was held that a party who seeks to incorporate into a contract a term which is particularly onerous *or* unusual must prove that the term has been fairly and reasonably drawn to the attention of the other party. Bingham LJ argued that cases on sufficiency of notice are concerned with the question 'whether it would in all the circumstances be fair (or reasonable) to hold a party bound by any conditions . . . of an unusual and stringent nature'. The utility of this general principle must surely be debatable and its application to the present facts even more so. The defendants were businessmen and were surely capable of reading the conditions on the delivery note. If they did not do so, they must be deemed to have accepted the risk that the terms might prove to be unacceptable to them. The objection that the terms were particularly onerous could possibly have been dealt with by arguing that condition 2 was a penalty clause, a point suggested by Bingham LJ. The difficulty with this argument is that the penalty clause rule only applies to sums payable on a breach of contract (see 21.7) and the defendants might not have been in breach of contract in retaining the transparencies beyond 14 days (for example, the claimants could have operated a two-tier price structure, with one fee being payable for the first 14 days and a different fee thereafter). But even

if the penalty clause rule was inapplicable, any unfairness in the terms sought to be incorporated into a contract should be dealt with directly, through a general doctrine of unfairness or unconscionability or, in the consumer context, by the Unfair Terms in Consumer Contracts Regulations 1999 (see 17.6) and not by distorting the rules relating to the incorporation of terms into a contract. The continued use of a special test for incorporation of onerous or unusual clauses is likely to give rise to practical difficulties in determining which clauses are caught by this rule. This point recently divided the Court of Appeal in *AEG (UK) Ltd* v. *Logic Resource Ltd* [1996] CLC 265, where the majority held that a clause requiring the purchaser to return defective goods at his own expense had not fairly and reasonably been drawn to the attention of the purchaser. Hobhouse LJ dissented and warned that

> 'if it is to be the policy of English law that in every case those clauses are to be gone through with, in effect, a toothcomb to see whether they were entirely usual and entirely desirable in the particular contract, then one is completely distorting the contractual relationship between the parties and the ordinary mechanisms of making contracts. It will introduce uncertainty into the law of contract.'

The point was well-made because the clause at issue was already subject to attack under the Unfair Contract Terms Act 1977 and, in the view of Hobhouse LJ, it was 'under the provisions of that Act that problems of unreasonable clauses should be addressed and the solution found'. All that the majority succeeded in doing was adding yet another layer of uncertainty. There is no need to apply different standards on the issue of incorporation according to the severity of the term sought to be incorporated; the same test should be applied to all terms, regardless of their severity.

9.5 Incorporation by a Course of Dealing

Terms may also be incorporated into a contract by a course of dealing. The courts have never defined course of dealing with any degree of precision, but some useful guidance was given by the House of Lords in *McCutcheon* v. *David MacBrayne Ltd* [1964] 1 WLR 125. There it was held that the course of dealing must be both regular and consistent. What constitutes a 'regular' course of dealing depends upon the facts of the particular case. Thus, in *Henry Kendall Ltd* v. *William Lillico Ltd* [1969] 2 AC 31, the House of Lords held that 100 similar contracts over a period of

three years constituted a course of dealing. But in *Hollier* v. *Rambler Motors (AMC) Ltd* [1972] 2 QB 71, three or four contracts over a period of five years were held not to be a course of dealing between a consumer and a garage. The position may, however, be different where the contracting parties are commercial parties of equal bargaining power. In *British Crane Hire Corporations Ltd* v. *Ipswich Plant Hire Ltd* [1975] QB 303, a clause was incorporated into the contract on the basis of two previous transactions and the custom of the trade. The court placed emphasis on the fact that the parties were of equal bargaining power, they were both in the trade and such conditions were habitually incorporated into these contracts.

The course of dealing must not only be regular, it must also be consistent. In *McCutcheon* v. *David MacBrayne Ltd* (above) a ferry belonging to the defendants sank and the claimant's car was lost. In the resulting action by the claimant, the defendants sought to rely on an exclusion clause contained in a risk note which, contrary to their usual practice, they had not asked the claimant's brother-in-law (who made the arrangement for the shipping of the claimant's car) to sign. The defendants' argument failed in the House of Lords because it was held that there was no consistent course of dealing on the basis of which the exclusion clause could be incorporated into the contract. Lord Pearce said that there was no consistent course of dealing because the previous transactions had always been in writing (that is, by the signing of the risk note) and in the present case the transaction was entirely oral. But this is surely to take the requirement of consistency too far because the only reason for the defendants' reliance upon the course of dealing argument was that they had forgotten to ensure that the risk note was signed. If that forgetfulness, of itself, also had the effect of precluding them from relying upon the course of dealing argument, cases of incorporation by a course of dealing will be very rare (see further Macdonald, 1988b). It is suggested that the better view of the case is that the evidence failed to establish a consistent course of dealing because, although on some occasions the brother-in-law had been asked to sign the risk note, there were other occasions when he had not been asked to sign. On this basis there was clearly no consistent course of dealing.

From the regularity and consistency of the course of dealing will be inferred knowledge of the conditions. In *McCutcheon* Lord Devlin said that previous dealings were only relevant if they proved actual knowledge of the terms and assent to them, but this view was not shared by other judges in the case and appears to have been rejected by the House of Lords in *Henry Kendall Ltd* v. *William Lillico Ltd* (above).

9.6 Interpretation

Once the terms of the contract have been ascertained, they must be interpreted to establish their 'true' meaning. Many contractual disputes arise out of disagreements over the proper interpretation of a particular phrase in a contract and most of them hinge upon the precise wording and context of the contract. When it comes to the interpretation of contracts, precedents are of relatively limited value: 'a decision on a different clause in a different context is seldom of much help on a question of construction' (*Surrey Heath Borough Council* v. *Lovell Construction Ltd* (1990) 48 Build LR 113, 118). Nevertheless, there are some broad principles which emerge with some clarity from the case law.

The starting-point is that it is for the courts, not the parties, to decide what is the proper interpretation of the contract. The guiding principle which the courts apply is that, in interpreting (or, as lawyers often say, 'construing') the contract, the court must seek to ascertain and give effect to the intention of the parties. However in some cases the process of imputing an intention to the parties is an extremely artificial one, which is sharply influenced by the court's view of the 'desirability' of the contract term which it is called upon to interpret. There is no better illustration of this than the approach which the courts have adopted to the interpretation of exclusion clauses, where rules of interpretation have been used in the past with particular venom in order to place difficult obstacles in the way of those who seek to exclude their liability towards others (see further 11.5–11.7). That this is indeed the case was recognised by Lord Diplock when he said that 'the reports are full of cases in which what would appear to be very strained constructions have been placed upon exclusion clauses' (*Photo Production Ltd* v. *Securicor Transport Ltd* [1980] AC 827).

With this point in mind let us examine the way in which the courts seek to ascertain the intention of the parties. The general rule is that their intention is to be ascertained from an *objective* assessment of the wording of the contract and of the surrounding circumstances. The 'methodology' of the common law is 'not to probe the real intentions of the parties but to ascertain the contextual meaning of the relevant contractual language. Intention is determined by reference to expressed rather than actual intention' (per Lord Steyn in *Deutsche Genossenschaftsbank* v. *Burnhope* [1995] 1 WLR 1580, 1587). Their intention must be ascertained from the document in which they have elected to enshrine their agreement (*Lovell & Christmas Ltd* v. *Wall* (1911) 104 LT 85). It is only in very limited circumstances that the courts can go outside the four corners of the

document. Therefore the actual words used in the document are of crucial significance.

The traditional approach of the courts to the interpretation of contracts was a literal one; thus in *Lovell & Christmas Ltd* v *Wall* (above) Cozens-Hardy MR stated that 'it is the duty of the court . . . to construe the document according to the ordinary grammatical meaning of the words used therein'. But in more recent years there has been a marked shift in the approach of the House of Lords away from a literal approach towards a purposive approach to interpretation, with particular emphasis being laid upon the adoption of an interpretation which has regard to the commercial purpose of the transaction. As Lord Steyn stated in his dissenting speech in *Deutsche Genossenschaftsbank* v. *Burnhope* [1995] 1 WLR 1580, 1589

> 'parallel to the shift during the last two decades from a literalist to a purposive approach to the construction of statutes there has been a movement from a strict or literal method of construction of commercial contracts towards an approach favouring a commercially sensible construction.'

He repeated this view in his speech in *Lord Napier and Ettrick* v. *R F Kershaw Ltd* [1999] 1 WLR 756, 763 when he stated:

> 'Loyalty to the text of a commercial contract, instrument, or document read in its contextual setting is the paramount principle of interpretation. But in the process of interpreting the meaning of the language of a commercial document the court ought generally to favour a commercially sensible construction. The reason for this approach is that a commercial construction is likely to give effect to the intention of the parties. Words ought therefore to be interpreted in the way in which a reasonable commercial person would construe them. And the reasonable commercial person can safely be assumed to be unimpressed with technical interpretations and undue emphasis on niceties of language.'

Reflecting this shift away from a literal interpretation of contractual documents, Lord Hoffmann in *Investors Compensation Scheme Ltd* v. *West Bromwich Building Society* [1998] 1 WLR 896, 912–913 re-stated in more modern form the principles by which contractual documents are now interpreted. He stated that the result of these principles, subject to one important exception, is to 'assimilate the way in which such documents are interpreted by judges to the common sense principles by which any serious utterance would be interpreted in ordinary life' and that, as

a consequence, 'almost all the old intellectual baggage of "legal" interpretation has been discarded'. He then set out the following five principles:

> '(1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation which they were at the time of the contract.
>
> (2) The background . . . [is] the "matrix of fact", but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.
>
> (3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way in which we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear. But this is not the occasion on which to explore them.
>
> (4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax . . .
>
> (5) The "rule" that words should be given their "natural and ordinary meaning" reflects the commonsense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had.'

This shift of emphasis towards a more purposive approach is now clearly discernible in the cases (see also *Mannai Investment Co Ltd* v. *Eagle Star Life Assurance Co Ltd* [1997] AC 749, 770 and *Total Gas Marketing Ltd* v. *Arco British Ltd* [1998] 2 Lloyd's Rep 209, 221) but it has not been without its critics (see, for example, Staughton, 1999). Four criticisms have been levelled against this purposive approach to interpretation. The first three essentially argue that the courts have gone too far down the purposive road, while the fourth criticism argues that the courts have not gone far enough.

The first and principal criticism has been that the purposive approach generates too much uncertainty in that it makes it more difficult to predict the outcome of the interpretative process. How will the courts decide what was the commercial purpose of the transaction? When will they choose to depart from the dictionary meaning of the words used? What evidence will they require before taking the step of rejecting the dictionary meaning? The claim that the modern approach has produced too much uncertainty may draw some support from the fact that the House of Lords has recently found it very difficult to reach agreement on issues of interpretation (for example, in *Mannai* their Lordships divided 3–2, and in both *West Bromwich* and *Burnhope* they divided 4–1). Furthermore, the dissents have been expressed in strong terms. For example, in *Burnhope* Lord Steyn expressed the view that the construction adopted by the majority was 'devoid of any redeeming commercial sense'. In *West Bromwich* the majority concluded that the phrase 'Any claim (whether sounding in rescission for undue influence or otherwise)' was actually used by the parties to mean 'Any claim sounding in rescission (whether for undue influence or otherwise)'. This was too much for the dissenting judge, Lord Lloyd. He concluded that this construction was simply not an available meaning of the words used and that, while purposive interpretation was a useful tool where the purpose could be identified with reasonable certainty, creative interpretation was not and that purposive interpretation must not be allowed to shade into creative interpretation. On the other hand, Lord Hoffmann, speaking for the majority, rejected Lord Lloyd's analysis on the basis that the words were not used by the parties in their natural sense and so, in his view, it was perfectly acceptable for the court to interpret the words in the way in which the parties must have understood them. Uncertainty is also caused by the fact that it is not clear how far this purposive approach will be carried. For example, exclusion clauses (see 11.5) and a clause in a contract which entitles a party to terminate a contract in certain circumstances have traditionally been subjected to stricter rules of construction. But in *British Fermentation Products Ltd* v. *Compair Reavell Ltd* [1999] BLR 352 and

Ellis Tylin Ltd v. *Co-operative Retail Services Ltd* [1999] BLR 205 Judge Bowsher applied the *West Bromwich* principles to the construction of an exclusion clause and a termination clause respectively. Does this mean that the old rules of interpretation have been or are about to be abandoned? There is no conclusive answer to this question but the answer would appear to be that the old restrictive rules of interpretation will have to give way where they do not give effect to the commercial purpose of the parties in inserting the clause into the contract. While there is no doubt that the purposive approach will, in these early days of its adoption, create a degree of uncertainty, most commentators seem to applaud the commercial sense to be found in this approach and to accept that a degree of uncertainty may turn out to be the price which has to be paid for the adoption of a more flexible, and hopefully fairer, approach to matters of construction (see McMeel, 1998).

The second criticism relates to the breadth of Lord Hoffmann's second principle. The emphasis on 'factual matrix' can be traced back to the speech of Lord Wilberforce in *Prenn* v. *Simmonds* [1971] 1 WLR 1381 but it has been criticised (see Staughton, 1999) on the ground that 'counsel have wildly different ideas as to what a matrix is and what it includes'. The breadth of the principle (in particular the use of the words 'absolutely anything') is likely to encourage lawyers to seek to adduce evidence which previously was inadmissible by introducing it under the guise of the 'matrix of fact'. Sir Christopher Staughton has stated (1999) that it 'is hard to imagine a ruling more calculated to perpetuate the vast cost of commercial litigation'. This may be something of an overstatement but it does emphasise the need for judicial caution in the interpretation of this second principle in order to ensure that it does not result in more protracted trials.

The third criticism relates to the breadth of Lord Hoffmann's fourth and fifth principles. In the first place it may encourage a party who has entered into a bad bargain (possibly even a party who is dishonest) to argue that he used a word or particular words in an unusual sense in order to extricate himself from his bad bargain. However the fact that Lord Hoffmann stated that 'we do not easily accept that people have made linguistic mistakes' may meet this criticism. But the more important criticism is that it may encourage judges to stray from the task of interpreting the contract and instead to assume the role of creating a contract for the parties (see in particular the dissent of Lord Lloyd in *West Bromwich* (above)). Yet the line between purposive interpretation (which is legitimate) and creative interpretation (which may not be legitimate) is not easy to draw. The courts have traditionally been unwilling to adopt a construction which leads to a very unreasonable result (see *Schuler AG* v.

Wickman Machine Tool Sales [1974] AC 235, discussed in more detail at 10.3). This approach to interpretation reflects the ordinary perception that contracting parties are unlikely to have agreed to something absurd. But this rule of construction has its limits, difficult though it may be to find them. As Lord Mustill stated in *Charter Reinsurance Co Ltd* v. *Fagan* [1997] AC 313, 388 there

> 'comes a point at which the court should remind itself that the task is to discover what the parties meant from what they have said, and that to force upon the words a meaning which they cannot fairly bear is to substitute for the bargain actually made one which the court believes could better have been made. This is an illegitimate role for a court.'

The fear of the critics is that the breadth of Lord Hoffmann's fourth and fifth principles will result in courts assuming that illegitimate role.

The fourth criticism is that Lord Hoffmann has not gone far enough in that evidence of pre-contractual negotiations remains inadmissible as does evidence of conduct subsequent to entry into the contract. Evidence of pre-contractual negotiations is generally inadmissible because, during the negotiating process, the parties' positions are constantly changing and it is only the final document which actually records their agreement. The exclusion of pre-contractual negotiations is not, however, absolute: where there is an ambiguity in the final written document, evidence of pre-contractual negotiations may be admissible to show that the parties had attached a particular meaning to that phrase (*The Karen Oltman* [1976] 2 Lloyd's Rep 708). Evidence of conduct subsequent to the making of the contract is also inadmissible because, were it otherwise, the contract could mean one thing on the day on which it was signed but mean something completely different one month after it was signed by virtue of the conduct of the parties after the making of the contract (*Schuler AG* v. *Wickman Machine Tool Sales* [1974] AC 235). But again evidence of conduct subsequent to the making of the contract may be relevant to a plea of estoppel, including estoppel by convention (*James Miller & Partners Ltd* v. *Whitworth Street Estates (Manchester) Ltd* [1970] AC 583; *Mannai Investment Co Ltd* v. *Eagle Star Life Assurance Co Ltd* [1997] AC 749, 768 (Lord Steyn) and 779 (Lord Hoffmann)). As Lord Hoffmann acknowledged in *West Bromwich*, the boundaries of these exceptions 'are in some respects unclear' and it may be that the courts will generally become more willing to admit evidence of pre-contractual negotiations and of conduct subsequent to the making of the contract. Support for such a development may be derived from Article 5–102 of the Principles of European Contract Law which states:

'In interpreting a contract, regard shall be had, in particular, to:

(a) the circumstances in which it was concluded, including the preliminary negotiations;
(b) the conduct of the parties, even subsequent to the conclusion of the contract;
(c) the nature and purpose of the contract;
(d) the interpretation which has already been given to similar clauses by the parties and the practices they have established between themselves;
(e) the meaning commonly given to terms and expressions in the branch of activity concerned and the interpretation similar clauses may already have received;
(f) usages; and
(g) good faith and fair dealing.'

Paragraphs (a), (b) and (g) seem clearly to go beyond the current limits of English law. Those who maintain that Lord Hoffmann has not gone far enough argue that English law should embrace propositions (a) and (b) so that courts will in future be free to assess for themselves the probative value of such evidence (which may not be great). On the other hand, care must be taken not to lengthen trials by enabling the parties to swamp the court with evidence of dubious value. Paragraph (g) is also of interest. As we shall note (see 12.10), English contract law currently does not impose on contracting parties a duty of good faith and fair dealing. However good faith and fair dealing play a vital role in civilian systems. A huge gulf thus appears to exist between English law and Continental systems. But the difference may be more one of technique than outcome. As Lord Hoffmann observed in *O'Neill* v. *Phillips* [1999] 1 WLR 1092, 1101, the result which an English court might achieve by adopting a less literal approach to interpretation might well by reached in a Continental court by the use of a general requirement of good faith. So, at the end of the day, they may turn out to be no more than 'different ways of doing the same thing'.

Finally, one particular rule of interpretation which is worthy of mention is the *contra proferentem* rule, according to which any ambiguity in a clause is interpreted against the party seeking to rely on it (the rule is discussed in greater detail in its application to exclusion clauses at 11.5). This rule is of general application and it gives to contracting parties an incentive to draft their contracts in clear and precise terms, because if they fail to do so, any doubt in a clause will be resolved against the party seeking to rely on it. The rule has also been reinforced by Regulation 7 of the Unfair Terms in Consumer Contracts Regulations 1999 which states that:

'(1) A seller or supplier shall ensure that any written term of a contract is expressed in plain, intelligible language.
(2) If there is doubt about the meaning of a written term, the interpretation most favourable to the consumer shall prevail . . .'

This is probably no more than another way of stating the *contra proferentem* rule.

9.7 Rectification

Once the contract has been interpreted, one of the parties may argue that the written agreement, as interpreted, fails to reflect the agreement which the parties actually reached. In such a case the court may be asked to rectify the document so that it accurately reflects the agreement which the parties did reach. Such was the case in *Lovell & Christmas Ltd* v. *Wall* (above) where the claimant asked the court to adopt a particular interpretation of the contract and, when that argument failed, sought to have the contractual document rectified. However it should be noted that there is a distinction between interpretation and rectification, although in many cases the line between the two is a fine one. Interpretation is the process of ascribing a meaning to a term of the contract. Rectification, on the other hand, is a process whereby a document, the meaning of which has already been ascertained, is rectified so that it gives effect to the intention of the parties. Nevertheless it must be conceded that there are cases in which the courts have corrected minor errors in the expression of a document by a process of construction rather than by rectification. Thus in *Nittan (UK) Ltd* v. *Solent Steel Fabrication Ltd* [1981] 1 All ER 633, the Court of Appeal read 'Sargrove Electronic Controls Ltd' as if it read 'Sargrove Automation' and thereby avoided the need to rectify the document. However this process of construction will only be used to correct very minor errors.

Rectification is a remedy which is concerned with defects not in the making, but in the recording, of a contract. This distinction can be illustrated by reference to the case of *Frederick E Rose (London) Ltd* v. *William H Pim Jnr & Co Ltd* [1953] 2 QB 450. The claimants were asked to supply certain buyers of theirs with a quantity of 'Moroccan horsebeans known here as feveroles'. The claimants did not know what feveroles were and so they asked the defendants, who replied that they were simply horsebeans. So the parties entered into a contract for the supply by the defendants to the claimants of 'horsebeans'. At the time of making the contract both parties believed that 'horsebeans' were 'feveroles'. It later

transpired that 'feveroles' were a more expensive variety of horsebean than the type which had been supplied to the claimants under the contract. When the claimants' buyers claimed damages from the claimants on the ground that the horsebeans which had been supplied to them were not 'feveroles', the claimants sought to have the contract with the defendants rectified by the insertion of the word 'feveroles'. The Court of Appeal refused to rectify the contract. This was not a case in which the document failed to record the intention of the parties. The document did reflect their prior agreement; it was simply the case that the parties were under a shared misapprehension that 'horsebeans' were 'feveroles'.

Rectification is an equitable discretionary remedy. As such, it is only available in the discretion of the court. Originally the courts were reluctant to exercise this discretion but gradually they have become more willing to do so. In deciding whether to rectify a document a court will have regard to the following considerations.

The first is that a court will only rectify a document where 'convincing proof' is provided that the document fails to record the intention of the parties (*Joscelyne* v. *Nissen* [1970] 2 QB 86). A high degree of proof is needed so that certainty is not undermined (*The Olympic Pride* [1980] 2 Lloyd's Rep 67, 73). The second is that the document must fail to record the intention of *both* parties. Unilateral mistake is insufficient of itself to base a claim to rectification (*Riverlate Properties* v. *Paul* [1975] Ch 133). But where one party mistakenly believes that the document correctly expresses the parties' common intention, and the other party is aware of that mistake, rectification may be available (*A Roberts and Co Ltd* v. *Leicestershire County Council* [1961] Ch 555). Where the defendant has been guilty of unconscionable conduct then the claimant may be entitled to rectification. An example of such unconscionable conduct was provided by Stuart-Smith LJ in *Commission for the New Towns* v. *Cooper (Great Britain) Ltd* [1995] Ch 259, 280 in the following terms:

> 'where A intends B to be mistaken as to the construction of the agreement, so conducts himself that he diverts B's attention from discovering the mistake by making false and misleading statements, and B in fact makes the very mistake that A intends, then notwithstanding that A does not actually know, but merely suspects, that B is mistaken, and it cannot be shown that the mistake was induced by any misrepresentation, rectification may be granted.'

Thirdly, the document must have been preceded by a concluded contract or by a 'continuing common intention'. It is no longer the case that a prior contract is a prerequisite to rectification. In *Joscelyne* v. *Nissen* (above) a

father and daughter agreed that the daughter would purchase the father's business and would, in return, pay all the expenses of the father's home, including the gas, electricity and coal bills. The formal contract signed by the parties made no mention of the fact that the daughter had agreed to pay these bills. There was no prior contract to which the court could have regard but it was held that there was sufficient evidence of a continuing common intention that the daughter pay the gas, electricity and coal bills to enable the court to rectify the agreement to give effect to their common intention. Finally, rectification will not be granted in favour of a claimant who has been guilty of excessive delay in seeking rectification, nor will it be granted against a bona fide purchaser for value without notice.

9.8 Implied Terms

In addition to the terms which the parties have expressly agreed, a court may be prepared to hold that other terms must be implied into the contract. Such terms may be implied from one of three sources.

The first is statute. Parliament has, in numerous instances, seen fit to imply terms into contracts. It is clear that these statutorily implied terms are not based upon the intention of the parties but on rules of law or public policy. As an illustration of statutorily implied terms we shall give very brief consideration to sections 12–15 of the Sale of Goods Act 1979. Thus it is an implied condition of a contract for the sale of goods that the seller has the right to sell the goods (s.12(1)) and there is an implied warranty that the goods are free from charges or incumbrances in favour of third parties (s.12(2)). There is also an implied condition that goods sold by description shall correspond with the description (s.13(1)) and that goods sold by sample shall correspond with the sample (s.15). In the case of a seller who sells goods in the course of a business, there is an implied condition that the goods supplied under the contract are of satisfactory quality (s.14(2)), except in relation to defects drawn to the buyer's attention before the contract was concluded or, in the case where the buyer examines the goods, as regards defects which that examination ought to reveal (s.14(2C)). Finally, where the seller sells goods in the course of a business and the buyer makes known to the seller any particular purpose for which the goods are being bought, there is an implied condition that the goods supplied under the contract are reasonably fit for that purpose (s.14(3)). The function of these implied terms is not to give effect to the intention of the parties but to provide some protection for the expectations of purchasers, particularly consumers. This element of 'consumer

protection' is further evidenced by the fact that the Unfair Contract Terms Act 1977 places severe restrictions upon the ability of sellers to exclude the operation of these implied terms and, indeed, as against a consumer, they cannot be excluded (see further 11.11).

The second source of implied terms are terms implied by custom. A contract may be deemed to incorporate any relevant custom of the market, trade or locality in which the contract is made (*Hutton* v. *Warren* (1836) 1 M & W 466), unless the custom is inconsistent with the express terms of the contract or its nature (*Palgrave, Brown & Son Ltd* v. *SS Turid (Owners)* [1922] 1 AC 397). A custom will generally be implied into a contract where it can be shown that the custom was generally accepted by those doing business in the particular trade in the particular place and was such that an outsider making inquiries could not fail to discover it (*Kum* v. *Wah Tat Bank Ltd* [1971] 1 Lloyd's Rep 439). A custom which satisfies these requirements binds both parties, whether they knew of it or not.

The third source of implied terms are terms implied at common law. There are, broadly speaking, two types of terms which are implied at common law (the distinction was recognised by Lord Bridge in *Scally* v. *Southern Health and Social Services Board* [1992] 1 AC 294, 306–7). The first type are sometimes called terms 'implied in fact'. This nomenclature seeks to convey the idea that the term is being implied as a matter of fact to give effect to what the court perceives to be the unexpressed intention of the parties. The test which must be satisfied before such a term will be implied into a contract is a stringent one. The test which is frequently employed by the courts is the 'officious bystander' test, the origin of which lies in the following statement:

> 'Prima facie that which in any contract is left to be implied and need not be expressed is something so obvious that it goes without saying; so that, if, while the parties were making their bargain an officious bystander were to suggest some express provision for it in the agreement, they would testily suppress him with a common "Oh, of course"' (MacKinnon LJ in *Shirlaw* v. *Southern Foundries Ltd* [1939] 2 KB 206, 207).

To put it another way: the implication must be 'necessary to give the transaction such business efficacy as the parties must have intended' (*The Moorcock* (1889) 14 PD 64). These tests were summarised by Lord Simon in *BP Refinery (Westernport) Pty Ltd* v. *Shire of Hastings* (1978) ALJR 20, 26 in the following terms:

> 'for a term to be implied, the following conditions (which may overlap) must be satisfied: (1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that "it goes without saying"; (4) it must be capable of close expression; (5) it must not contradict any express term of the contract.'

Although the reasonableness of the term is a relevant factor in deciding whether or not to imply a term into the contract, it must be emphasised that the court does not have power to imply a term into a contract simply because it is reasonable to do so. Although Lord Denning has advocated such an approach (*Liverpool CC* v. *Irwin* [1976] QB 319) it has been rejected by the House of Lords, who insisted that the term must be a necessary one before it will be implied (*Liverpool CC* v. *Irwin* [1977] AC 239; see also *Hughes* v. *Greenwich London Borough Council* [1994] AC 170). The necessity test at least allows the court to base its reasoning on the intention of the parties and it avoids the court being seen overtly to be 'making' the contract for the parties (on which see 4.1).

So a high standard must be satisfied before such a term will be implied into a contract. Attempts to imply a term have therefore failed where one of the parties did not know of the term which it was alleged must be implied (*Spring* v. *NASDS* [1956] 1 WLR 585) and where it was not clear that both parties would in fact have agreed to the term (*Luxor (Eastbourne) Ltd* v. *Cooper* [1941] AC 108). The courts are also reluctant to imply a term where the parties have entered into a carefully drafted written contract containing detailed terms agreed between them: in such a case a court is likely to presume that the written contract constitutes a complete code and so refuse to imply any term into it (*Shell UK Ltd* v. *Lostock Garages Ltd* [1976] 1 WLR 1187). Further, as Lord Simon stated in *BP Refinery (Westernport) Pty Ltd* v. *Shire of Hastings* (above), a term will not be implied into a contract if it would be inconsistent with the express wording of the contract (see also *Duke of Westminster* v. *Guild* [1985] QB 688). However, where the meaning of the express term is in doubt and the court is called upon to interpret that term, an implied term may, by a process of interpretation, be invoked to cut down or limit the literal scope of the express term so that the express and the implied terms can thus co-exist 'without conflict' (*Johnstone* v. *Bloomsbury Health Authority* [1992] QB 333, 350–1 per Browne-Wilkinson VC, although contrast the approach of Stuart-Smith LJ who suggests (pp.343–5) that a term implied in law (see below) may prevail over an express inconsistent term of the contract).

Secondly terms, known as terms 'implied in law', may be implied into

all contracts of a particular type. Thus terms are frequently implied into contracts of employment and into contracts between landlords and tenants, not on the basis of the relationship between the particular parties, but as a general incidence of the relationship of employer and employee or landlord and tenant. To take the employment relationship as our example, there is an implied term that an employee will serve his employer faithfully and that he will indemnify his employer for liabilities incurred as a result of his wrongful acts in the course of his employment (*Lister* v. *Romford Ice & Cold Storage Co Ltd* [1957] AC 555). Equally it has been held that there is an implied term to the effect that the employer must not 'without reasonable and proper cause conduct [himself] in a manner calculated or likely to destroy or seriously damage the relationship of confidence and trust between the parties' (*Courtaulds Northern Textiles Ltd* v. *Andrew* [1979] IRLR 84 and *Mahmud* v. *Bank of Credit and Commerce International SA* [1998] AC 20, 44–45 (Lord Steyn)). In these cases, and the many other cases in which the courts have implied terms into contracts of employment, it seems clear that the implication is not based on the 'officious bystander' test, but on some less stringent test which reflects the court's perception of the nature of the relationship between an employer and an employee and whether such an implied term is suitable or 'reasonable' for incorporation in all such contracts (for an example in the context of a landlord and tenant relationship see *Liverpool CC* v. *Irwin* (above)). As Lord Bridge put it in *Scally* v. *Southern Health and Social Services Board* [1992] 1 AC 294, 306, there is

> 'a clear distinction between the search for an implied term necessary to give business efficacy to a particular contract and the search, *based on wider considerations*, for a term which the law will imply as a necessary incident of a definable category of contractual relationship'

(emphasis added, but note the criticisms of Phang, 1993, pp.243–50).

Summary

1. Once the contracting parties have elected to enshrine their contract in a written document, the courts have held that, as a general rule, the parties cannot adduce extrinsic evidence to add to, vary or contradict the written document.
2. This 'rule' is called the *parol evidence* rule but it is the subject of so many exceptions that it is unlikely to have significant effects in practice.
3. As a general rule a person is bound by a document which he signs, whether he reads it or not, except where his signature has been procured by fraud, misrepresentation or the defence of *non est factum* is made out.
4. *Non est factum* means this is not my deed. It is a defence which is available to

those who are permanently or temporarily unable through no fault of their own to have without explanation any real understanding of a particular document. The difference between the document as it was and as it was believed to be must be radical or substantial or fundamental. A person who signs the document carelessly, without bothering to read it properly, cannot invoke the defence.

5 Contracting parties may agree to incorporate a set of written terms into their contract. In order to do so, notice must be given at or before the time of contracting, be contained in a document which was intended to have contractual effect and reasonable steps must be taken to bring the terms to the attention of the other party.
6 Terms may also be incorporated into a contract by a course of dealing. The course of dealing must be both regular and consistent.
7 When interpreting a contract the court must seek to ascertain and give effect to the intention of the parties. The intention of the parties must generally be derived from the document in which they have expressed their agreement. The courts have gradually moved away from a literal approach to interpretation towards a purposive approach, with particular emphasis being laid upon the adoption of an interpretation which has regard to the commercial purpose of the transaction.
8 Evidence of pre-contractual negotiations, of conduct subsequent to the making of the contract and of the parties' subjective intentions is generally inadmissible.
9 Rectification is a remedy which is concerned with defects not in the making, but in the recording, of a contract. It is an equitable discretionary remedy.
10 A court will only rectify a document where 'convincing proof' is provided that the document fails to record the intention of the parties, where the document fails to record the intention of *both parties* (unless one party knows that the other is mistaken) and the document must have been preceded by a concluded contract or by a 'continuing common intention'.
11 Terms may be implied into a contract by statute, by custom or by the common law. In the case of 'terms implied in fact' a court cannot imply a term simply because it would be reasonable to do so; it must be necessary to imply such a term (in other words it must pass the 'officious bystander' test).

Exercises

1 What is the 'parol evidence rule'? List the principal exceptions to the rule.
2 What is *non est factum*? In what circumstances is the defence available to an adult of full capacity?
3 Is it correct to say that the cases on sufficiency of notice are concerned with the question 'whether it would in all the circumstances be fair (or reasonable) to hold a party bound by any conditions . . . of an unusual and stringent nature'?
4 When is a course of dealing 'regular and consistent'?
5 What types of evidence are inadmissible when a court seeks to interpret a written contract?
6 What is rectification? When is it available?
7 In what circumstances may a term be implied into a contract? Do courts ever imply terms into a contract on the basis that it was 'just and reasonable' so to do?

10 The Classification of Contractual Terms

10.1 The Classification of Terms

Not all contract terms are of equal significance; some are more important than others. For example, if I were to enter into a contract to buy a new car, the make of the car, its roadworthiness and the price would be much more important to me than its colour. This fact has long been reflected in contract law in the distinction which has traditionally been drawn between a condition and a warranty.

A condition is an essential term of the contract which goes to the root or the heart of the contract. Thus, in the example of my purchase of a new car, the terms as to the make of the car, its roadworthiness and the price would all be conditions. A warranty, on the other hand, is a lesser, subsidiary term of the contract, such as the term relating to the colour of the car (unless it was part of the description of the car, in which case it would be treated as a condition under s.13(1) of the Sale of Goods Act 1979; see 9.8). The distinction between a condition and a warranty is vital in the event of a breach of contract. A breach of a condition enables the party who is not in breach of contract ('the innocent party') *either* to terminate performance of the contract and obtain damages for any loss suffered as a result of the breach *or* to affirm the contract and recover damages for the breach. A breach of a warranty only enables the innocent party to claim damages, that is to say he cannot terminate performance of the contract and must therefore continue to perform his obligations under the contract. So if, in our example, I wished to terminate the contract to purchase the car and to return the car to the sellers, it would be essential for me to show that the sellers had broken a condition of the contract because, if the sellers had only broken a warranty, I would be confined to a remedy in damages.

It may seem odd to discuss the classification of contractual terms at this stage in the book if the primary significance of the classification relates to breach of contract. However the justification for doing so lies in the fact that the distinction is an important one in contract law and we shall encounter it on a number of occasions before we reach the chapter on breach of contract (Chapter 19).

10.2 What is a 'Condition'?

Before embarking upon a more detailed discussion of the distinction between a condition and a warranty, it is necessary to deal with a preliminary point relating to the meaning of the word 'condition'. The word 'condition' can be used in a number of different senses and it is important to have a clear grasp of the meanings which contract lawyers ascribe to this word. In the first place it could mean some event upon which the existence of the contract hinges. Such conditions are commonly called contingent conditions. A contingent condition may be either a condition precedent or a condition subsequent. A condition precedent provides that the contract shall not become binding until the occurrence of a specified event (*Pym* v. *Campbell* (1856) 6 E & B 370). For example, I enter into an agreement to buy a car but the agreement provides that it shall not become binding until the car passes a road test; if the car fails the road test no contract comes into existence. A condition subsequent provides that a previously binding contract shall come to an end on the occurrence of a stipulated event. So if I enter into a binding contract, supported by consideration, under which I promise to pay £50 a month to my daughter Rachel until she gets married, the occurrence of her marriage will determine the contract between us. In both cases the effect of the occurrence of the condition is to terminate the agreement without either party being in breach of contract because, in the case of the condition precedent, neither party promised that the condition would be fulfilled and, in the case of the condition subsequent, neither party promised that the condition would not occur.

However we are not concerned here with such contingent conditions; we are concerned with promissory conditions. A promissory condition is a term of a contract under which one party promises to do a particular thing and a failure on his part to perform the promised act constitutes a breach of contract.

10.3 Distinguishing Between a Condition and a Warranty

Having established that we are discussing promissory conditions, it is now necessary to explain how it is decided whether a term is a condition or a warranty. We shall approach this issue by examining the situations in which a term has been held to be a condition. A term may be held to be a condition in one of three ways: by statutory classification, by judicial classification or by the classification of the parties.

Firstly, a term may be classified as a condition by statute. We have

already noted (see 9.8) that sections 12–15 of the Sale of Goods Act 1979 imply certain terms into contracts for the sale of goods. These sections also classify these implied terms; thus the implied terms as to satisfactory quality, fitness for purpose and compliance with description and sample are declared to be conditions, whereas the implied term that the goods are free from charges and incumbrances in favour of third parties is stated to be a warranty.

Secondly, a term may be classified as a condition by the courts. There are two grounds, apart from the stipulation of the parties, on which courts may decide that a term is a condition. The first is where performance of the term goes to the root of the contract so that, by necessary implication, the parties must have intended that the term should be treated as a condition, breach of which would entitle the other party to treat himself as discharged (see *Couchman* v. *Hill* [1947] KB 544, discussed at 8.3). Although the term must go to the root of the contract, it need not be the case that every breach of the term should deprive the innocent party of substantially the whole benefit which it was intended that he would obtain from the contract (*Bunge Corp* v. *Tradax Export SA* [1981] 1 WLR 711). When seeking to ascertain the significance of the term which has been broken, the courts will have regard to the views and practices of the commercial community. As Kerr LJ has stated, the court is, in the absence of any other 'more specific guide', making 'what is in effect a value judgment about the commercial significance of the term in question' (*State Trading Corporation of India Ltd* v. *M Golodetz Ltd* [1989] 2 Lloyd's Rep 277, 283). In particular, where a decision has been made by an experienced trade arbitrator or tribunal as to the status of a particular term and that decision is based upon the commercial significance of the term, the courts will be extremely reluctant to interfere with the finding of that arbitrator or tribunal (*State Trading Corporation of India Ltd* v. *M Golodetz Ltd* [1989] 2 Lloyd's Rep 277, 284 and *The Naxos* [1990] 1 WLR 1337, 1348).

The second ground on which a court may decide that a term is a condition is that binding authority requires the court to hold that the term is a condition. In some industries, parties trade on standard terms and a decision that a particular standard term is a condition will affect not only that contract, but also all subsequent contracts of that type. Thus a stipulation in a voyage charterparty relating to the time at which the vessel is expected ready to load is generally treated as a condition (*The Mihalis Angelos* [1971] 1 QB 164). The governing factor here is the need for certainty. But certainty carries with it a price. That price is that, in some cases, a party has been held to be entitled to terminate for breach of a condition, even though the breach has caused him little or no hardship. The

most infamous example is, perhaps, *Arcos Ltd* v. *E A Ronaasen & Son* [1933] AC 470. Timber, described in the contract as half an inch thick, was bought to be used in making cement barrels. The timber, as delivered, was 9/16 inch thick but this did not impair its utility for making cement barrels. Nevertheless the buyers were held to be entitled to reject the timber, even though their motive in doing so was clearly that the market price for timber had fallen. As Professor Brownsword has stated (1992):

> 'the objection to the decision in *Arcos* is not so much that the buyers were allowed to act unreasonably or inefficiently by rejecting goods which they could use, but that they were allowed to reject such goods in order to take advantage of a falling market. In short, the objection is that the buyers acted in bad faith.'

The buyers can be said to have acted in bad faith because the reason which they gave for exercising the right to terminate (the thickness of the timber) was not the 'real reason' and further that the 'real reason' was not attributable to the consequences of the breach but to the fact that they had entered into what had turned out to be a bad bargain. The courts are not presently concerned to ascertain the 'real reason' for the decision to terminate: as long as the party asserting the right to terminate does actually possess it, the courts will not inquire into the motives behind its assertion. Arguably, the courts are right to adopt this approach because of the cost and uncertainty which would be created by inquiries into the actual motives of the party seeking to exercise the right to terminate.

The third method of classification is the parties' own classification of the contractual term. Thus, if a contract states that a particular term is a condition, the term will generally be regarded as a condition; similarly where the contract expressly states that breach of the term will entitle the other party to terminate performance of the contract. This ability to classify a term as a condition gives an extremely powerful weapon to contracting parties, as can be seen from the case of *Lombard North Central plc* v. *Butterworth* [1987] QB 527. A contract for the hire of computers stated in clause 2 of the agreement that it was of the essence of the contract that the hirer should pay each instalment promptly. The hirer failed to pay certain instalments promptly, whereupon the owners retook possession of the computers and sued the hirer for damages. The Court of Appeal held that making punctual payment of the essence of the contract was sufficient to turn the failure to pay a single instalment into a repudiation of the contract, thus entitling the claimant owners to terminate the contract and recover, not only in respect of arrears as at the date of termination, but also the loss of future instalments (subject to a discount for

accelerated receipt of the future rentals). The court held that there was no restriction upon the right of the parties to classify the relative importance of the terms of their contract. It has been objected that such a principle 'does not always lead to a desirable result' (Bojczuk, 1987) but Mustill LJ refused to subject such terms to the control of the penalty clause jurisdiction (see 21.5) on the ground that to do so would be 'to reverse the current of more than 100 years' doctrine, which permits the parties to treat as a condition something which would not otherwise be so'.

However, the court must be satisfied that the parties intended to use the word 'condition' in its technical sense. In *Schuler AG* v. *Wickman Machine Tool Sales Ltd* [1974] AC 235, clause 7(b) of a four-year distributorship agreement stated that 'it shall be a condition of this agreement that [Wickman] shall send its representatives to visit [six named UK manufacturers] at least once in every week for the purpose of soliciting orders'. Wickman failed to make some visits to the named manufacturers. Schuler claimed that they were therefore entitled to terminate the agreement because Wickman had broken a 'condition' of the agreement. This argument was rejected by the House of Lords. Lord Reid held that the use of the word 'condition' was an 'indication', perhaps even a 'strong indication', that the parties intended the term to be a condition in the technical sense, but it was by no means 'conclusive' evidence. He held that the more unreasonable the consequences of treating a term as a condition in its technical sense, the less likely it was that the parties intended to use the word 'condition' in such a way. On the facts, the consequence that a 'failure to make even one visit' would entitle Schuler to terminate the contract 'however blameless Wickman might be' was so unreasonable that it compelled Lord Reid to interpret 'condition' in clause 7(b) in its non-technical sense. Lord Wilberforce dissented. He attacked the majority approach on the ground that it assumed, 'contrary to the evidence, that both parties . . . adopted a standard of easy-going tolerance rather than one of aggressive, insistent punctuality and efficiency'. There is much force in this criticism. Perhaps, at the end of the day, the vital factor in the case was that the contract was 'poorly drafted' so that the majority were able to employ this lack of clarity to justify their decision to refuse to adopt a construction which produced what was, in their view, an 'unreasonable' or 'absurd' result.

Although contracting parties are free to create conditions by stipulating that performance of a particular obligation shall be of the essence of the contract, it is vital to note that *both parties* must agree to this classification before the term can enjoy the status of a condition. The position is entirely different where *one party* serves a notice on the other party purporting to make performance of a particular obligation 'of the essence

of the contract'. Let us suppose that one party fails to comply with the terms of a warranty, thus giving rise only to a claim for damages. Can the innocent party give the party in breach notice requiring him to perform the obligation within a certain period of time, stating that a failure to do so will be regarded as a repudiatory breach giving rise to a right to terminate (thus making performance 'of the essence of the contract')? Two issues must be distinguished here. The first relates to the entitlement of the innocent party to serve such a notice; the second concerns the effect of the notice. In relation to the first issue, the innocent party is entitled to serve such a notice because the right to give notice is not confined to essential terms of the contract but can be exercised in relation to any term of the contract (*Behzadi* v. *Shaftesbury Hotels Ltd* [1992] Ch. 1). Notice can be served at the moment of breach: it is not necessary to wait for a reasonable time to elapse before serving it (see *Behzadi* (above)). The period of notice given must, however, be reasonable; an issue which depends upon all the facts and circumstances of the case. The vital issue is therefore the second one, namely the effect of such a notice. In *Re Olympia & York Canary Wharf Ltd (No. 2)* [1993] BCC 159, Morritt J rejected the argument that a failure to comply with a time of the essence notice was of itself sufficient to constitute a repudiation of the contract. It is suggested that this is correct because, if failure to comply did of itself amount to a repudiation it would, in effect, give to one party the power unilaterally to turn a non-essential term into an essential term. There is all the difference in the world between a term which both parties agree to classify as a condition and a term which both parties agree to classify as a warranty but one party purports unilaterally to elevate to the status of a condition. On this view the function of a 'time of the essence' notice is limited: a failure to comply in respect of a non-essential term will not constitute a repudiation of the contract but at most will provide evidence from which a court may be prepared to infer that a repudiatory breach has occurred.

10.4 The Need for Change?

It can be seen that the primary emphasis in these cases has been upon the importance of the *term* which has been broken rather than upon the importance of the consequences of the *breach* of that term. The result has been that, in cases such as *Arcos* v. *Ronaasen* (above), a term has been classified as a condition even though the consequences of breach were insignificant. The justification for this approach is, firstly, that the parties must be free to classify the relative importance of their own contractual

terms (see *Lombard North Central* v. *Butterworth* (above)) and, secondly, the need for certainty in commercial transactions. Certainty can be achieved most effectively by deciding whether or not a term is a condition according to the nature of the term broken, not by requiring the parties to wait and examine the consequences of the breach before deciding whether or not they are sufficiently serious to justify the classification of the term as a condition. The cause of certainty is further advanced by the fact that, once a term is classified as a condition, the innocent party is, unless barred by estoppel, by his election to affirm the contract (on which see further 19.8), or by statute (see section 15A of the Sale of Goods Act 1979, below), automatically entitled to terminate performance of the contract. But it is important not to over-state the certainty which is achieved by classifying a term as a condition. It is true that, once a term has been classified as a condition a significant measure of certainty is thereby achieved, but uncertainty can still arise in relation to the prior question of whether the term which has been broken is actually a condition. For example, in *The Naxos* [1990] 1 WLR 1337 a majority of the House of Lords held that the obligation of the seller to have the cargo ready for delivery at any time within the contract period was a condition, whereas a majority of the Court of Appeal and the first instance judge were of the opinion that it was not. This uncertainty is, however, largely confined to previously unclassified terms and, while it should not be ignored, it should not detract from the principal point which is that the classification of a term as a condition does give rise to a greater degree of certainty in commercial transactions.

But the cost of this emphasis on the need to promote certainty is an element of injustice, in cases such as *Arcos* v. *Ronaasen* (above), where the motive for terminating the contract was that the contract had turned out to be a bad bargain for the innocent party. Such injustice could be largely avoided if the critical factor in deciding whether a term was a condition (and hence whether the innocent party was entitled to terminate performance of the contract) was to become the consequences of the breach. Then the innocent party would only be entitled to terminate performance of the contract where the consequences to him of the breach were sufficiently serious (indeed there was authority for such a proposition in the early case of *Boone* v. *Eyre* (1777) 1 H Bl 273, before the emphasis switched to the importance of the term which had been broken in cases such as *Behn* v. *Burness* (1863) 3 B & S 751 and *Bettini* v. *Gye* (1876) 1 QBD 183). Yet the cost of such a shift in emphasis would be the sacrifice of a degree of certainty.

A further criticism which has been levelled against too great a willingness to classify a term as a condition is that it encourages termination of

contracts rather than their performance. As Roskill LJ stated in *The Hansa Nord* [1976] QB 44:

> 'in principle, contracts are made to be performed and not to be avoided according to the whims of market fluctuation and where there is a free choice between two possible constructions I think the court should tend to prefer that construction which will ensure performance, and not encourage avoidance of contractual obligations.'

The *Hansa Nord* was a case, like *Arcos* v. *Ronaasen*, where the buyer was searching for a way out of a bad bargain and it is true that, in this context, a refusal to classify a term as a condition is more likely to lead to contractual performance. But in other contexts this is not so. The classification of a term as a condition can give an incentive to a would-be contract-breaker to perform his obligations under the contract because breach will expose him to a claim for loss of bargain damages. The hirer in *Lombard North Central plc* v. *Butterworth* (above) will, presumably, take greater steps to perform his obligations under any future contract of hire he may conclude, knowing the draconian consequences which can follow from breach of a condition. In this sense, classification of a term as a condition could be said to act as an incentive to performance rather than termination. So this argument, ultimately, is not convincing and it is the apparent injustice of cases such as *Arcos* which is the real basis for arguments for reform.

So, in this context, what we have is, essentially, a conflict between the interests of 'certainty' and the interests of 'justice' or 'fairness'. 'Certainty' requires the focus to be upon the nature of the term broken and demands a high degree of remedial rigidity. 'Justice', on the other hand, requires the focus to be on the consequences of the breach and demands a high degree of remedial flexibility. The generally accepted view was that, in cases such as *Arcos* v. *Ronaasen*, the pendulum had swung too far in favour of the promotion of certainty and that it was time to redress the balance.

In seeking to redress the balance, three approaches have been adopted. The first is to seek to limit the number of terms which are classified as conditions. Thus, in *Reardon Smith Line Ltd* v. *Hansen Tangen* [1976] 1 WLR 989, Lord Wilberforce stated that some of the authorities which we have discussed were 'excessively technical and due for fresh examination' by the House of Lords. But these cases still await 'fresh examination' by the House of Lords and it is unlikely that this line of approach will be further developed.

The second approach has been to address the fact situation in *Arcos* v.

Ronaasen directly and place a statutory restriction upon the right of a buyer to reject goods. This has been done by section 15A of the Sale of Goods Act 1979 (as inserted by the Sale and Supply of Goods Act 1994) which states in subsection (1) that where the buyer would, apart from this subsection, have the right to reject goods by reason of a breach on the part of the seller of a term implied by sections 13–15 of the Sale of Goods Act 1979, but the breach is so slight that it would be unreasonable for him to reject them, then, if the buyer does not deal as consumer, the breach is not to be treated as a breach of a condition but may be treated as breach of warranty. Thus the buyer in such a case would be confined to a claim in damages. It is for the seller to show that the breach is slight so as to preclude the buyer from rejecting the goods (s.15A(3)). At first sight this provision seems apt to encompass the fact situation in *Arcos* but in fact it all depends upon the meaning to be given to the word 'slight'. As Professor Treitel has pointed out (1999, p.744) 'the difference between half an inch and 9/16 of an inch is by no means obviously "slight" (at least as a proportion)' and if it is not slight the buyer is not deprived of his right to reject no matter how unreasonable his decision to reject. This new provision is also limited in a number of other respects. The first is that it only applies to a breach by the seller of one of the terms implied by sections 13–15 of the 1979 Act: it has no application to a breach by the seller of section 12 of the Act, to the breach of an express term of the contract and it has no application whatsoever to the seller's right to terminate following a breach by the buyer. The second limitation is that it only applies where the buyer is not a consumer. A consumer buyer is not to be deprived of his right to reject the goods and confined to a claim in damages because damages are unlikely to be an adequate remedy for a purchaser who has not bought with a view to re-selling the goods. Thus the new provision only applies in a commercial context. This seems strange because the provision reduces certainty at the very point at which it is most needed. Some attempt has been made to preserve certainty by enacting that the new restriction shall apply 'unless a contrary intention appears in, or is to be implied from the contract' (s.15A(2)). The meaning to be given to s.15A(2) is not initially obvious but it is intended to exclude from the reform clauses such as time clauses where it is generally accepted that a breach should give rise to a right to terminate (see 10.5). Notwithstanding the inclusion of s.15A(2), the effect of this reform is to take away a degree of certainty in commercial transactions but the limits to which it is subject (particularly the exclusion of seller termination following buyer breach) make it hard to resist the conclusion of Treitel (1999, p.745) that 'the section has sacrificed certainty without attaining justice'.

The third approach is one of more general application and it has been

to focus more attention on the consequences of the breach and thereby to give the courts greater remedial flexibility. This has been achieved through the recognition of the fact that the distinction between a condition and a warranty is not an exhaustive one.

10.5 Innominate Terms

A third classification has now been recognised in English law: the intermediate or the innominate term. The origin of this development can be found in the judgment of Diplock LJ in *Hong Kong Fir Shipping Co Ltd v. Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 26, 70 when he said:

> 'There are many . . . contractual undertakings . . . which cannot be categorised as being "conditions" or "warranties" . . . . Of such undertakings all that can be predicated is that some breaches will and others will not give rise to an event which will deprive the party not in default of substantially the whole benefit which it was intended that he should obtain'.

An innominate term can be distinguished from a condition on the ground that breach of an innominate term does not automatically give rise to a right to terminate performance of the contract and it can be distinguished from a warranty on the ground that the innocent party is not confined to a remedy in damages. Thus the court is given a greater degree of remedial flexibility and it can focus attention on the consequences of the breach by allowing a party to terminate performance of the contract only where the breach of the innominate term has had serious consequences for him. Yet it is this remedial flexibility which is, itself, problematic because one can never be entirely sure whether one has the right to terminate when faced with a breach by the other party. In deciding whether or not the breach was of a sufficiently serious character the courts will have regard to all the relevant circumstances of the case. Carter (1991) has helpfully identified the following factors which are relied upon by the courts: (i) any detriment caused, or likely to be caused, by the breach; (ii) any delay caused, or likely to be caused, by the breach; (iii) the value of any performance received by or tendered to the party not in breach; (iv) the cost of making any performance given or tendered by the party in breach conform with the requirements of the contract; (v) any offer by the party in breach to remedy the breach; (vi) whether the party in breach has previously breached the contract or is likely to breach it in the future; and (vii) whether the party not in breach will be adequately compensated by

an award of damages in respect of the breach. Not only is this list of factors extremely broad, but the weight which is accorded to each one must depend, to a large extent, on the facts of the case. The uncertainty thereby caused is important because, if a contracting party gets it wrong and purports to terminate when he was not in fact entitled to do so (because the breach was not repudiatory), he will be held to have repudiated his obligations under the contract and may be liable to pay substantial damages in consequence. Uncertainty can carry with it a real price.

The creation of this new category of innominate terms leaves us with the further difficulty of distinguishing between an innominate term, a condition and a warranty. In practice, classification of a term as a warranty is rare but such a classification is not entirely without significance. A party who is in breach of contract may wish to argue that the term which has been broken is a warranty rather than an innominate term so as to restrict the innocent party to a remedy in damages and to deprive him of the ability to terminate. Contracting parties are free to classify terms as warranties, just as they are free to classify terms as conditions, but if they wish to confine a term to the status of a warranty, they should 'make it plain from the contract as a whole' that that is their intention (*Re Olympia & York Canary Wharf Ltd (No. 2)* [1993] BCC 159, 166). If the contract states that the term is a condition then, subject to *Schuler* v. *Wickman*, it will be treated as a condition. A term will also be regarded as a condition where it is classified as such by statute. Where the term has been previously classified by the judiciary as a condition then, cases such as *Arcos* v. *Ronaasen* apart, it is likely that the term will continue to be regarded as a condition. The principal difficulty is likely to arise in connection with previously unclassified terms.

At this point we return to the conflict which we have already noted between the interests of 'certainty' and 'justice'. If primary attention is given to considerations of fairness, this will favour classification of terms as innominate terms because the remedy can be tailored to the facts of the case. On the other hand, an approach which gives primary attention to considerations of certainty will favour classification as a condition because the remedial consequences will then be clear. Some indication of the likely resolution of this conflict can be gleaned from the case of *Bunge* v. *Tradax* (above). The House of Lords held that a term which related to the time of performance in a commercial contract was a condition and not an innominate term on the ground that time was generally of the essence in such contracts. However Lord Wilberforce said that 'the courts should not be too ready to interpret contractual clauses as conditions'. This suggests that, apart from terms which are commercially vital where

the need for certainty is greatest, greater consideration will be given to the interests of 'justice' by classifying contract terms as innominate terms in order to give the courts flexibility in granting the appropriate relief. A good example of this is provided by *The Hansa Nord* [1976] QB 44, a case which bears some resemblance to *Arcos* v. *Ronaasen* (and which would now fall within s.15A of the Sale of Goods Act 1979 if the consequences of the breach were 'slight': see 10.4 (above)). Buyers of citrus pulp purported to reject the cargo on the ground that shipment was not made in 'good condition'. The price of the cargo was £100,000. The sellers were compelled to sell the cargo and the buyers, acting through an agent, managed to repurchase it for £30,000 and they were able to use the citrus pulp for its original intended purpose. The Court of Appeal held that the term which had been broken was not a condition and, applying *Hong Kong Fir*, they concluded that the term was an innominate one and that the consequences of the breach were not sufficiently serious to give rise to a right to terminate. The buyers were therefore confined to a claim in damages to reflect the loss in value of the cargo caused by its defective state. On this approach, the injustice of cases such as *Arcos* v. *Ronaasen* need no longer occur.

Summary

1 Contract terms can be classified either as conditions, warranties or innominate terms.
2 A condition is an essential term of the contract which goes to the root or the heart of the contract. This is a promissory condition which must be distinguished from a contingent condition, which is some event upon which the existence of the contract hinges. A contingent condition may be either a condition precedent or a condition subsequent.
3 A term may be classified as a promissory condition by statute, by judicial classification or by the classification of the parties. In the latter category the court must be satisfied that the parties intended to use the word 'condition' in its technical sense.
4 Breach of a promissory condition entitles the innocent party either to terminate performance of the contract and claim damages or to affirm the contract and claim damages.
5 A warranty is a lesser, subsidiary term of the contract. Breach of a warranty only gives a remedy in damages.
6 The category of innominate terms was recognised by the Court of Appeal in the *Hong Kong Fir* case.
7 An innominate term can be distinguished from a condition on the ground that breach of an innominate term does not automatically give rise to a right to terminate performance of the contract and it can be distinguished from a warranty on the ground that the innocent party's remedy is not confined to damages. Classification as an innominate term therefore gives the court an important degree of remedial flexibility.

Exercises

1 Distinguish between a promissory condition and a contingent condition.
2 When will a term be classified as a promissory condition?
3 What are the remedial consequences of classifying a term as
(a) a condition;
(b) a warranty; and
(c) an innominate term?

11 Exclusion Clauses

An exclusion clause may be defined as a 'clause in a contract or a term in a notice which appears to exclude or restrict a liability or a legal duty which would otherwise arise' (Yates, 1982, p.1). Exclusion clauses are a common feature of contracts today and may take a number of different forms. The most frequently encountered types of exclusion clauses are those which seek to exclude liability for breach of contract or for negligence or which seek to limit liability to a specified sum. Another type of exclusion clause commonly encountered is an indemnity clause, under which one contracting party promises to indemnify the other for any liability incurred by him in the performance of the contract (for a description of other types of exclusion clauses see Yates, 1982, pp.33–41).

11.1 Exclusion Clauses: Defence or Definition?

Despite the common occurrence of exclusion clauses in contracts, differing views remain as to their essential nature. Let us take an example to illustrate the point. John, who presently lives in Colchester, wishes to have his furniture transported to his new house in Preston and for this purpose he contracts with Peter. Peter, who is self-employed, offers a price which is substantially lower than any other removal firm because he offers no insurance cover for the goods while they are in transit; instead he relies on the owner of the goods either to use his existing insurance policy (if it is applicable) or to take out his own special insurance policy. In order to give effect to his pricing policy Peter inserts a clause into his contracts to the following effect: 'no liability is accepted for any damage, howsoever caused, to any goods during the course of transit'. Two views may be adopted as to the function of such a clause.

One view holds that this clause simply defines the obligations which the contracting parties have chosen to accept. Peter has only accepted a limited obligation to transmit the goods and has never accepted any liability for damage to the goods during the course of transit. On this view the function of the exclusion clause is to assist in *defining* the obligations of the parties. This view is not, however, the one which the courts have traditionally adopted. Courts have traditionally seen exclusion clauses as performing a defensive function. On this view a failure by Peter to deliver

the goods safely to Preston constitutes a breach of contract and the role of the exclusion clause is to provide Peter with a *defence* to John's action for breach of contract.

Yet a closer examination of this traditional view reveals a serious difficulty. The difficulty is that Peter has not accepted an absolute obligation to deliver John's goods; such a conclusion could only be reached by ignoring the exclusion clause when defining Peter's obligations. But why should the exclusion clause be ignored in defining Peter's obligations, when it is via the exclusion clause that Peter has sought to define the extent of his obligations and it is only by this means that he can offer a service at a price lower than that of his competitors? There can surely be no justification for ignoring the exclusion clause in this manner. The clause is simply one means, albeit an important one, by which Peter has attempted to *define* his obligations. If this view of exclusion clauses is accepted, the justification for subjecting exclusion clauses to distinct regulation largely disappears because such clauses then become functionally indistinguishable from every other term of the contract which assists in defining the obligations which the parties have accepted towards each other (this theory was initially developed by Coote, 1964, and is also supported by Yates, 1982).

The argument that exclusion clauses define the obligations of the parties has been attacked by Adams and Brownsword (1988a) on the ground that it is 'elegantly formalistic' and that it ignores 'both the historical development of the problem, and the realities of the situation'. The 'historical development' is that the growth in the use of standard form contracts has been accompanied by a growth in the use of exclusion clauses and the 'realities' of the situation are that such terms are offered on a 'take it or leave it basis'. In short, these standard form contracts, which so often include sweeping exclusion clauses, are imposed on the weaker party to the transaction. They take away the rights of the weaker party and nullify his expectations rather than define the obligations of the parties. But it is only by looking outside the contract for the initial existence of these 'rights' or 'expectations' that exclusion clauses can be said to 'take away' the 'rights' of the weaker party or nullify his 'expectations'. These 'rights' and 'expectations' must exist outside the contract because the contract as a whole certainly did not confer them upon the weaker party. How then are we to ascertain the scope of these 'rights' or 'expectations'? Are they to be found in some conception of 'public policy'? Proponents of the 'defensive' view of exclusion clauses do not tell us. Surely the evil which we are seeking to eradicate is not the existence of exclusion clauses or even simply the existence of 'unreasonable exclusion clauses' but the existence of 'unfair' terms in a contract. If this is so, then

the correct approach must be to deal with exclusion clauses as part of a general doctrine of duress, inequality of bargaining power or 'unconscionability' (see further Chapter 17) and not by the artificial and misleading process of subjecting exclusion clauses to distinct regulation on the basis that they are a defence to a breach of an obligation (see Yates, 1982, ch. 7). Notwithstanding the force of this criticism, the courts and Parliament have generally treated exclusion clauses as a defence to a breach of an obligation, although, as we shall see, this view has given rise to considerable difficulties.

11.2 The Functions of Exclusion Clauses

Before embarking upon an analysis of the detailed rules of law, we must identify the different functions of exclusion clauses. Exclusion clauses perform a number of useful functions. First, they help in the allocation of risks under the contract. In our example involving Peter and John the risk of damage to the goods is clearly allocated to John and there is no need for Peter to take out insurance cover; double insurance is thereby avoided. Secondly, exclusion clauses can help reduce litigation costs by making clear the division of responsibility between the parties. Thirdly, exclusion clauses are often used in standard form contracts which, by enabling people, such as Peter, to mass-produce their contracts, helps reduce the cost of negotiations and of making contracts.

On the other hand, exclusion clauses can perform a function which is socially harmful in that, as we have already seen, they can be used by the powerful in society to exclude liability towards the weaker party, thereby leaving the weak without a remedy. It is this socially undesirable function of exclusion clauses which has provided significant impetus for reform of this area of law and which explains the restrictive approach which the courts have adopted in their treatment of exclusion clauses.

11.3 An Outline of the Law

A contracting party who wishes to include an exclusion clause in a contract must overcome three hurdles before he can do so. First, it must be shown that the exclusion clause is properly incorporated into the contract (11.4). Secondly, it must be shown that, properly interpreted, the exclusion clause covers the loss which has arisen (11.5–11.7). Thirdly, there must be no other rule of law which would invalidate the exclusion clause (11.8–11.15).

Historically, it was the first two of these three stages which were important. The principal explanation for this is that, although at common law the court has power to strike down contract terms which are 'contrary to public policy' (see 15.6–15.16), it did not have the power to hold exclusion clauses invalid because they were unreasonable (despite arguments to the contrary by Lord Denning in cases such as *Levison* v. *Patent Steam Carpet Cleaning Co Ltd* [1978] QB 68). Deprived of the ability to strike down unreasonable exclusion clauses by such direct means, the courts sought to achieve such a goal by the indirect means of adopting a restrictive approach towards the incorporation (9.4 and 11.4) and the interpretation (11.5–11.7) of exclusion clauses. Lord Denning recognised this in *Gillespie Bros* v. *Roy Bowles Ltd* [1973] 1 QB 400, 415 when he said that 'judges have . . . time after time, sanctioned a departure from the ordinary meaning. They have done it under the guise of "construing" the clause. They assume that the party cannot have intended anything so unreasonable. So they construe the clause 'strictly'. They cut down the ordinary meaning of the words and reduce them to reasonable proportions. They use all their skill and art to that end'.

But now, since courts have been given statutory power under the Unfair Contract Terms Act 1977 (UCTA) to control exclusion clauses, there is less need for them to use the first two stages to control unreasonable exclusion clauses and hence it can be expected that the focus of attention will switch to the third stage (although contrast the restrictive approach which was adopted towards incorporation in the case of *Interfoto Picture Library Ltd* v. *Stiletto Visual Programmes Ltd* [1989] QB 433 (discussed at 9.4), which although not an exclusion clause case, shows that the restrictive approach to incorporation is still very much alive).

11.4 Incorporation

At the first stage it must be shown that the exclusion clause was validly incorporated into the contract. Here the reader should refer to the discussion of incorporation at 9.4.

11.5 Construction of Exclusion Clauses

At the second stage it must be shown that the exclusion clause, properly interpreted or properly construed, covers the damage which was caused. Had the courts adopted a definitional approach to exclusion clauses then such clauses would have been subject to the same rules of interpretation

as any other term of the contract. But one consequence of the courts' adoption of the defensive approach to exclusion clauses has been that exclusion clauses have not been interpreted in the same way as other terms of the contract; they have been interpreted more rigorously or restrictively.

The general approach which the courts have adopted to the interpretation of exclusion clauses is a restrictive one, under which the exclusion clause is interpreted strictly against the party seeking to rely on it. This rule is called the '*contra proferentem*' rule. The effect of the rule is that any ambiguity in the exclusion clause is resolved against the party seeking to rely on it. Although the *contra proferentem* rule is applicable to any ambiguous term in a contract, it has been applied particularly stringently to exclusion clauses. The 'proferens' is simply the person seeking to rely on the exclusion clause; 'proferens' does not imply that the person seeking to rely on the exclusion clause has 'imposed' it on the other party (*Scottish Special Housing Association* v. *Wimpey Construction UK Ltd* 1986 SLT 173).

One consequence of the application of the *contra proferentem* rule has been a game of 'cat and mouse' between contract draftsmen and the courts, as draftsmen have sought to evade the restrictive interpretations adopted by the courts. This can be illustrated by reference to the following two cases. In *Wallis, Son and Wells* v. *Pratt and Haynes* [1911] AC 394, a contract for the sale of seeds contained a clause which stated that the sellers gave 'no warranty express or implied' as to the description of the seeds. The seeds did not correspond with the description so the buyers brought an action for damages against the sellers, who sought to rely on the exclusion clause. It was held that they could not do so because it only covered breach of a 'warranty' and, in failing to provide seeds which corresponded with the description, the sellers had broken a condition (the distinction between a condition and a warranty is discussed at 10.1). The impact of this ruling can be seen in *Andrews Bros (Bournemouth) Ltd* v. *Singer and Co Ltd* [1934] 1 KB 17. This time the exclusion clause stated that 'all conditions, warranties and liabilities *implied* by statute, common law or otherwise are excluded'. The claimants contracted with the defendants to buy some 'new Singer cars'. One of the cars delivered by the defendants was a used car. The claimants sued for damages and the defendants sought, unsuccessfully, to rely on the exclusion clause. Greer LJ said that the defendants were probably trying to escape the effect of *Wallis* but the only problem was that, although they had included the word 'condition', they had omitted the word 'express' and this was fatal because the court held that the defendants had broken an express term of the contract.

However, this strict approach may now be undergoing some reconsideration. In *Ailsa Craig Fishing Co Ltd* v. *Malvern Fishing Co Ltd* [1983] 1 WLR 964, the House of Lords held that, in the case of limitation clauses, the *contra proferentem* rule did not apply with the same rigour as it applied to exclusion clauses (it has also been held that the principles applicable to monetary limitation clauses are equally applicable to time limitation clauses, where the clause limits the liability of the defendant by reference to a period of time, such as one year from the date of the conclusion of the contract: see *BHP Petroleum Ltd* v. *British Steel plc* [1999] 2 Lloyd's Rep 583, 592). Lord Fraser and Lord Wilberforce said that limitation clauses were not viewed with the same hostility as exclusion clauses because of their role in risk allocation and because it was more likely that the other party would agree to a limitation clause than an exclusion clause. This approach is open to the objection that it ignores the risk allocation function of exclusion clauses and it is by no means certain that the other party would be more willing to agree to a limitation clause, especially where the limit is derisory (see Palmer, 1982). Instead of differentiating between exclusion clauses and limitation clauses, one would have expected uniform rules of construction to be applied to all contract terms. Such an approach has not, however, commended itself to the House of Lords and they have since followed *Ailsa Craig* in *George Mitchell (Chesterhall) Ltd* v. *Finney Lock Seeds Ltd* [1983] 2 AC 803. On the other hand, the High Court of Australia in *Darlington Futures Ltd* v. *Delco Australia Pty Ltd* (1987) 61 ALJR 76, has refused to differentiate between exclusion clauses and limitation clauses in this manner. Instead the court held that

> 'the interpretation of an exclusion clause is to be determined by construing the clause according to its natural and ordinary meaning, read in the light of the contract as a whole, thereby giving due weight to the context in which the clause appears including the nature and the object of the contract and, where appropriate, construing the clause *contra proferentem* in case of ambiguity.'

This approach is to be welcomed in so far as it adopts a more natural interpretation of exclusion clauses. Some support for a more clement approach can also be found in some English cases. As we have already noted (9.4), in *Photo Production Ltd* v. *Securicor Transport Ltd* [1980] AC 827, Lord Diplock said that 'the reports are full of cases in which what would appear to be very strained constructions have been placed upon exclusion clauses'. He noted that many of these cases involved consumer contracts and continued, 'any need for this kind of judicial distortion of

the English language has been banished by Parliament's having made these kinds of contract subject to the Unfair Contract Terms Act 1977'. It should be noted that in neither *Photo Production* nor *Darlington Futures* was the *contra proferentem* rule doubted; in both cases all that the court was saying was that it will operate only in cases of genuine ambiguity and that in future exclusion clauses should be given a more natural construction.

It is to be hoped that, in future cases, courts will continue the move towards the adoption of a more natural interpretation of exclusion clauses. This move is likely to derive support from the re-statement of the principles by which contractual documents are to be interpreted which is to be found in the speech of Lord Hoffmann in *Investors Compensation Scheme Ltd* v. *West Bromwich Building Society* [1998] 1 WLR 898, 913–914 (on which see 9.6). There are already signs that the courts will apply these principles to the interpretation of exclusion clauses (see, for example, *British Fermentation Products Ltd* v. *Compair Reavell Ltd* [1999] BLR 352).

However there remain at least two situations in which particular rules of construction are employed by the courts. These rules apply where one party seeks to exclude liability for his own negligence (11.6) or where he seeks to exclude liability for a 'fundamental breach' (11.7). We shall now discuss these two special rules of construction.

11.6 Negligence Liability

The first relates to the situation where a contracting party seeks to exclude liability for his own negligence (note that UCTA contains severe restrictions on the ability of a contracting party to exclude liability for his own negligence even where it is clear that the clause, on its proper construction, covers negligently inflicted damage; see 11.10). The courts regard it as inherently unlikely that one party will agree to allow the other contracting party to exclude liability for his own negligence. To give effect to this, the courts have evolved three specific rules of construction which find their origin in the speech of Lord Morton of Henryton in *Canada Steamship Lines Ltd* v. *The King* [1952] AC 192.

The first rule is that if a clause contains language which expressly exempts the party relying on the exclusion clause from the consequences of his own negligence then (subject to UCTA) effect must be given to the clause. This test may be fulfilled by using a word which is a synonym for negligence (*Smith* v. *UBM Chrysler (Scotland) Ltd* 1978 SC (HL) 1) such as 'any act, omission, neglect or default' (*Monarch Airlines Ltd* v. *London*

Luton Airport Ltd [1998] 1 Lloyd's Rep 403, 409). The safest course, however, is to use the word 'negligence' expressly. The words 'loss whatsoever or howsoever occasioned' do not count as an express reference for this purpose (*Shell Chemicals UK Ltd* v. *P&O Roadtanks Ltd* [1995] 1 Lloyd's Rep 297, 301).

If the first rule is not satisfied the court will then proceed to apply the second and the third limbs of Lord Morton's test. It is important to understand that, while the first rule stands alone, the second and the third rules constitute a double hurdle which must be overcome by a clause which fails to satisfy the first rule. The second rule is that the court must consider whether the words are wide enough, in their ordinary meaning, to cover negligence on the part of the party relying on the exclusion clause. If a doubt arises as to whether the words are wide enough, the doubt must be resolved against the party relying on the clause. Exclusion clauses which have been held wide enough to satisfy this test include clauses which exclude liability for 'any act or omission' or 'any damage whatsoever'.

Once the second rule has been satisfied, the court must then apply the third rule and consider whether the exclusion clause may cover some kind of liability other than negligence. If there is such a liability, the clause will generally be confined in its application to that alternative source of liability and will be held not to extend to negligently inflicted loss. It was once thought that the mere existence of a possible alternative source of liability meant that the clause could not cover negligence, but the point has since been reconsidered by the Court of Appeal in *The Raphael* [1982] 2 Lloyd's Rep 42 (see Palmer, 1983). In the latter case it was held that the rules laid down in *Canada Steamship* were merely aids to be used by the courts in identifying the intention of the parties and it was emphasised that where the alternative source of liability was 'fanciful or remote' it would not prevent the exclusion clause covering liability in negligence. But what if the alternative source of liability was sufficiently realistic for the parties to intend the clause to apply to that other source of liability? Does such an alternative source of liability mean that the clause cannot apply to negligence? Stephenson LJ thought so. On the other hand Lord Donaldson and May LJ held that the point was ultimately one of construction but even they said that in such a case the clause would generally be interpreted as not excluding liability for negligence.

The combination of the second and the third rules can produce results which are unsatisfactory and contrary to the intention of the parties. Two particular problems can be identified. The first is that the two rules make contradictory demands of the draftsman. The second rule demands that the clause be drafted as widely as possible so that it will be held to

encompass negligently inflicted damage. But the third rule demands that the clause be narrow in scope because the wider it is, the more likely it is that it will encompass some source of liability other than negligence and so be confined in its scope to that alternative source of liability. A number of clauses have been caught by this dilemma: they surmount the second rule, only to fall at the third because the clause is held to be confined to the alternative, non-negligent source of liability (see, for example, *Dorset County Council* v. *Southern Felt Roofing Co Ltd* (1989) 48 Build LR 96).

The second problem is that the parties may intend the same clause to apply both to negligently inflicted damage and to non-negligently inflicted damage. In our example involving Peter and John (see 11.1), Peter may wish the exclusion clause to cover not only negligence on his part, but also any liability which he may incur for late delivery of the furniture through no fault of his own (for example, his van may break down and John may incur expenses living in a hotel in Preston while waiting for the furniture to arrive). In such a case, the application of the *Canada Steamship* rules would be more likely to frustrate that intention than give effect to it, and rules which so frustrate the intention of the parties should be abandoned at the first opportunity. It is therefore suggested that the courts should no longer apply the *Canada Steamship* rules but should leave the issue as one of construction, with the courts simply having to decide, as a matter of construction, whether or not the exclusion clause covered negligently caused damage. Such a step was taken by the Supreme Court of Victoria in *Schenker & Co (Aust) Pty Ltd* v. *Malpas Equipment and Services Pty Ltd* [1990] VR 834, 846, where McGarvie J stated that the strained approach to construction adopted in *Canada Steamship* was inconsistent with the more natural and ordinary rules of construction adopted by the High Court of Australia in *Darlington Futures* (above). He justified this departure from strained rules of construction on the following ground:

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

It is suggested that there is much to be said for this view, but in *EE Caledonia Ltd* v. *Orbit Valve Co Europe* [1993] 4 All ER 165, 173, Hobhouse J took the opposite approach and chose to affirm and apply the *Canada Steamship* rules in emphatic terms. He stated:

> 'it has to be borne in mind that commercial contracts are drafted by parties with access to legal advice and in the context of established legal principles as reflected in the decisions of the courts. Principles of certainty, and indeed justice, require that contracts be construed in accordance with the established principles. The parties are always able by the choice of appropriate language to draft their contract so as to produce a different legal effect. The choice is theirs.'

While certainty is indeed an important commodity in the law of contract, the approach of Hobhouse J is open to criticism on a number of grounds. The first is that parties do not always have access to legal advice. The second is the fact that parties can contract out of the rule does not justify the rule itself. Finally, the continued existence of an unsatisfactory rule imposes costs on commerce because the parties must bear the cost of negotiating their way out of an inconvenient rule. The better approach, it is suggested, would be to rid the law of the arbitrary *Canada Steamship* rules, leaving the courts to apply the *contra proferentem* rule in the usual way. Unfortunately the Court of Appeal has chosen instead to affirm the approach of Hobhouse J and has endorsed the *Canada Steamship* rules in strong terms on a number of occasions recently (see *EE Caledonia Ltd* v. *Orbit Valve Co Europe* [1994] 1 WLR 1515; *The Fiona* [1994] 2 Lloyd's Rep 506; and *Shell Chemicals UK Ltd* v. *P&O Roadtanks Ltd* [1995] 1 Lloyd's Rep 297, 301).

11.7 Fundamental Breach

The second situation in which the courts have evolved specific rules of interpretation is where the breach of contract by the party relying on the exclusion clause is of a fundamental nature. Two distinct approaches have been adopted here and it is vital to understand the difference between the two. The first approach may be called the rule of law approach, under which it was not possible by a clause (however widely drafted) to exclude liability for certain breaches of contract which were deemed to be fundamental. This approach grew under the guiding hand of Lord Denning as a means of control over exclusion clauses which were thought to be unreasonable. The second approach may be called the rule of construction approach. According to this approach the question whether an exclusion clause covered a fundamental breach was a question of construction, under which the clause was interpreted against the party seeking to rely on it.

In *Suisse Atlantique Société d'Armament Maritime SA* v. *NV Rotter-*

damsche Kolen Centrale [1967] 1 AC 361, the House of Lords held that the latter approach was the correct one but, unfortunately, their Lordships' judgments were not a model of clarity and their ambiguities were seized upon in cases such as *Harbutt's Plasticine Ltd* v. *Wayne Tank Pump Co Ltd* [1970] 1 QB 477, to resurrect the rule of law approach. However, the rule of law approach was finally laid to rest by the House of Lords in *Photo Production Ltd* v. *Securicor Transport Ltd* [1980] AC 827. The claimants, who were factory owners, entered into a contract with the defendants, under which the defendants contracted to provide periodic visits to the claimants' factory during the night for the purpose of checking that the factory was secure. During one of these visits an employee of the defendants started a fire, apparently to keep himself warm, but which got out of control and burnt down the factory.

The claimants sought to recover damages of £648,000 from the defendants, but the defendants relied on an exclusion clause which stated that 'under no circumstances' were they 'to be responsible for any injurious act or default by any employee . . . unless such act or default could have been foreseen and avoided by the exercise of due diligence on the part of [the defendants]'. The House of Lords held that it was a question of construction whether or not the exclusion clause covered a fundamental breach and that, on the facts, the defendants were not liable because the exclusion clause did, in fact, cover the damage which had arisen.

It is undoubtedly the case that much mystique surrounds the doctrine of fundamental breach. This is largely due to the difficulties and confusion created by the rule of law approach. Now that the rule of law approach has been laid to rest, the 'doctrine' simply exists as a rule of construction, according to which the more serious the breach, or the consequences of the breach, the less likely it is that the court will interpret the exclusion clause as applying to the breach. As Neill LJ stated in *Edmund Murray Ltd* v. *BSP International Foundations Ltd* (1993) 33 Con LR 1, 16, 'it is always necessary when considering an exemption clause to decide whether as a matter of construction it extends to exclude or restrict the liability in question, but, if it does, it is no longer permissible at common law to reject or circumvent the clause by treating it as inapplicable to "a fundamental breach"'. (See also Unfair Contract Terms Act 1977, s.9).

Although the rule of law approach has gone, great care must still be taken when drafting a term which seeks to exempt one party from the consequences of a particularly serious breach. Therefore if a contracting party wishes to exclude liability for (i) breach of a fundamental term of the contract (that is a term which goes to the root of the contract or forms

the essential character of the contract, see *Karsales (Harrow) Ltd* v. *Wallis* [1956] 1 WLR 936), (ii) a deliberate refusal to perform his obligations under the contract (*Sze Hai Tong Bank Ltd* v. *Rambler Cycle Co Ltd* [1959] AC 576) or (iii) a breach which will have particularly serious consequences for the other party, then he must use clear words to such an effect if he is to achieve his purpose. Yet even here, as we have already noted, the House of Lords in *Photo Production* stated that a strained construction should not be put upon words in an exclusion clause which are clearly and fairly susceptible of only one meaning.

11.8 Other Common Law Controls upon Exclusion Clauses

There are certain additional controls over exclusion clauses which exist at common law. The common law limitations are of much less significance since the intervention of Parliament (see 11.9). A party cannot rely on an exclusion clause, the effect of which he has misrepresented to the other party (*Curtis* v. *Chemical Cleaning and Dyeing Co Ltd* [1951] 1 KB 805). Similarly, an exclusion clause which is contained in a written document can be overridden by an express inconsistent undertaking given at or before the time of contracting (*Couchman* v. *Hill* [1947] KB 554). Finally, it must be remembered that the courts have no power at common law to strike down an exclusion clause simply because it is unreasonable (see 11.3).

11.9 The Unfair Contract Terms Act 1977

Parliament has now assumed the major role in regulating the use of exclusion clauses in contracts. The principal legislation which it has enacted in pursuance of this role is the Unfair Contract Terms Act 1977 (UCTA, see also the Unfair Terms in Consumer Contracts Regulations 1999 (SI 1999, No. 2083), discussed in more detail at 17.6). The Act is a complex and technical piece of legislation. It is important to bear in mind that here we are dealing with an Act of Parliament and the *exact* words used by the Act must be studied and applied.

While the Act gives the courts considerable power to regulate exclusion clauses, it is vital to note that English law still does not recognise the existence of a general doctrine of unfairness or unconscionability (see 17.4). It is only particular types of clause, such as exclusion or limitation clauses, which are picked out for regulation. One consequence of this

approach is that Parliament must define what constitutes an exclusion or a limitation clause and the courts must in turn interpret that definition. The focus is therefore upon the *form* of *the clause* which is the subject of the control rather than upon the *substance* of *the contract* taken as a whole. The result is that difficult threshold questions can arise in deciding whether or not the clause in the contract falls within the scope of the Act. If it does, it will be subjected to the reasonableness test (unless it is declared by the Act to be void), but if it falls outside the scope of the Act then there is no general doctrine of unfairness or unreasonableness to which the party seeking to set aside the term can appeal. This has given rise to various jurisdictional difficulties as contracting parties have sought to evade the clutches of the Act by arguing that the clause at issue does not fall within the scope of the Act. In the following sections of this chapter we shall look at the various clauses which fall within the scope of the Act and explore one or two of the 'jurisdictional' issues which have arisen.

11.10 Negligence Liability

The first issue which the Act deals with are attempts to exclude or restrict liability for negligently inflicted loss. Section 2 provides that:

> '(1) A person cannot by reference to any contract term or to a notice given to persons generally or to particular persons exclude or restrict his liability for death or personal injury resulting from negligence.
> (2) In the case of other loss or damage, a person cannot so exclude or restrict his liability for negligence except in so far as the term or notice satisfies the requirement of reasonableness.
> (3) Where a contract term or notice purports to exclude or restrict liability for negligence a person's agreement to or awareness of it is not of itself to be taken as indicating his voluntary acceptance of any risk.'

A number of points should be noted about this section. The first is that it only applies to 'negligence', so that it does not apply to attempts to exclude or restrict liability which is strict (that is to say, liability which arises irrespective of fault). 'Negligence' is defined in s.1(1) as

> '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.'

An act is not prevented from being an act of negligence on the ground that the breach of duty was intentional rather than inadvertent, or because liability for it arose vicariously rather than directly (s.1(4)).

The second point to note about section 2 is that it applies only to attempts to exclude or restrict 'liability' and that liability for this purpose is confined to 'business liability'. Business liability is defined in s.1(3) as

'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 . . . .'

'Business' is defined in s.14 as including a profession and the activities of any government department or local or public authority.

The third point to note is that the section is not confined in its application to contracts: it also extends to non-contractual notices which purport to exclude or restrict liability for negligence. Fourthly, it should be noted that section 2 adopts two methods of control. The first, contained in s.2(1), is that any contract term or notice which attempts to exclude or restrict liability for negligence causing death or personal injury is *void*. Personal injury is defined in s.14 as including 'any disease and any impairment of physical or mental condition'. The second method of control, contained in s.2(2), is that attempts to exclude or restrict liability for negligence causing loss or damage other than death or personal injury are valid only if they satisfy the requirement of *reasonableness* (the reasonableness test is discussed at 11.14).

Finally, we must turn to the 'jurisdictional' issues which have arisen, or may arise, under s.2. As has been noted, the section refers to a party attempting to 'exclude or restrict his liability' for negligence and negligence itself is defined in s.1 as the 'breach' of an obligation or a duty. Section 2 is therefore drafted in defensive terms, that is to say, it assumes that there has been a *breach* of duty and so does not appear to extend to clauses which define the obligations of the parties. So how would a court respond to the argument that the clause which is the subject-matter of

the litigation simply defined the obligations of the parties and therefore fell outside the scope of section 2?

Such an argument was put to the Court of Appeal in *Phillips Products Ltd* v. *Hyland and Hamstead Plant Hire Co Ltd* [1987] 2 All ER 620. The defendants 'hired' a JCB excavator and driver to the claimants. Condition 8 of the contract stated that the driver was to be regarded as the employee of the claimants and that the claimants alone should be responsible for all claims arising in connection with the driver's operation of the excavator. Owing to the negligence of the driver, the JCB excavator crashed into the claimants' factory wall. The claimants sued for damages and the defendants sought to rely upon condition 8. The claimants argued that condition 8 was caught by s.2(2) of UCTA and that it failed to satisfy the requirement of reasonableness. The defendants argued that condition 8 was not caught by s.2(2) on the ground that there was no negligence within the meaning of s.1(1)(b) because there had been no breach of their obligations as they had never accepted any liability for the acts of the driver. This argument was rejected by the Court of Appeal. Slade LJ asserted that, in considering whether there has been a breach of duty under s.1(1), the court must leave out of account the clause which is relied on by the defendants to defeat the claimants' claim. But why should condition 8 be left out of account when it was via that clause that the defendants had sought to define their obligations? Slade LJ claimed to find further support for his analysis in s.13(1) of the Act which extends the scope of s.2 to encompass 'terms and notices which exclude or restrict the relevant obligation or duty'. It is clear that the function of this provision is to extend the scope of s.2 to certain duty-defining clauses. The aim of the provision is probably to prevent evasion of the Act by clever draftsmen employed by the more powerful party to the contract. But the difficulty which it causes lies in ascertaining the *extent* to which it applies to duty-defining clauses. Section 13(1) does not give us any criteria by reference to which we can decide which duty-defining clauses are caught by the Act and which are not.

The scope of s.13 was discussed by the House of Lords in *Smith* v. *Eric S Bush* [1990] 1 AC 831. Lord Templeman stated that the Act subjected to regulation 'all exclusion notices which would in common law provide a defence to an action for negligence'. Lord Griffiths interpreted s.13 as 'introducing a "but for" test in relation to the notice excluding liability'; that is to say, a court must decide whether a duty of care would exist 'but for' the exclusion clause. Lord Jauncey stated that the wording of s.13 was 'entirely appropriate to cover a disclaimer which prevents a duty coming into existence'. But surely the Act does not catch all duty-defining clauses? Ridiculous conclusions would be reached if it did (for some

examples, see Palmer and Yates, 1981, and Palmer, 1986). One example will suffice to illustrate the point: 'an overworked accountant says to a potential investor "this is all I can remember about Company X but I may be wrong so don't rely on me"' (Palmer, 1986). Is such a statement caught by the Act? The answer is not clear. But if it is, how can a person qualify his obligations without being caught by the Act? This lack of clarity is almost certain to result in confusion in the courts. Although the courts must share some responsibility for the creation of this confusion, the confusion lies, ultimately, at the heart of UCTA in its misconception of the function of exclusion clauses (see 11.1), and until that issue is resolved the courts will continue to experience considerable difficulty in identifying the clauses which fall within the scope of the Act.

Two further examples can be given of these difficulties. The first is provided by *Thompson* v. *T Lohan (Plant Hire) Ltd* [1987] 2 All ER 631, a case which can be usefully contrasted with *Phillips* v. *Hylands* (above). Once again the case concerned the hiring of an employee and a JCB excavator and a claim arising out of the negligence of the driver. The contract term which was the subject of the dispute was a new version of condition 8 (the variation is of no significance for present purposes). But this time it was held that condition 8 was not caught by section 2 of UCTA. In *Thompson*, the driver's negligence led to the death of Mr Thompson. Mr Thompson's widow recovered damages from the general employers who then sought to recover an indemnity from the hiring employers under condition 8. The hiring employers argued that condition 8 was caught by s.2(1) of the Act and was therefore ineffective. However it was held that condition 8 was not caught by s.2(1) and so was effective to transfer liability to the hiring employer. The vital issue which divides these two cases is whether or not it is sought to *exclude* liability towards the *victim* of the negligent act. In *Thompson*, condition 8 did not attempt to exclude liability towards the victim of the driver's negligence (Mr Thompson) because his widow had recovered from the general employers and the issue was whether that liability could be *transferred* from the general employers to the hiring employers. On the other hand, condition 8 in the *Phillips* case was relied upon in an effort to *exclude* liability towards the *victim* of the driver's negligence (the claimants) and therefore was caught by s.2(2) (see further Adams and Brownsword, 1988b). This distinction between an *exclusion* and a *transfer* of liability can lead to haphazard results in practice. Suppose that the driver in *Phillips*, instead of damaging a wall belonging to the claimants, had damaged a wall belonging to a third party, who sought and recovered damages from the general employer. In any action brought by the general employer against the hirers to recover the sum paid to the third party, s.2 would be irrelevant

because there would then be no attempt to exclude a liability towards the victim of the negligence (the third party). Such a conclusion makes it impossible for a lawyer to state in advance whether the clause will be caught by s.2 because it all depends upon whose wall is damaged and whether the person who is seeking to recover damages is the victim of the negligence. But should it not be the case that, whether the property which is damaged belongs to the claimants or not, the result in each case should be the same? Either the risk has been fairly allocated or it has not. Distinctions of the type drawn in *Phillips* and *Thompson* are incoherent in policy terms and reflect the insecure foundations upon which UCTA is built.

The second example of these jurisdictional difficulties can be provided by reference to the decision of the House of Lords in *Scottish Special Housing Association* v. *Wimpey Construction UK Ltd* [1986] 1 WLR 995. Wimpey were employed by the SSHA to modernise some houses which were owned by SSHA. During the course of the work, the houses were damaged by fire caused by the alleged negligence of Wimpey. Wimpey relied upon the terms of the contract as a defence to SSHA's claim for damages. Clause 18(2) of the contract stated that Wimpey were liable for any damage to the property caused by their negligence 'except for such loss or damage as is at the risk of the employer under clause 20(C)' of the contract. Clause 20(C) stated that 'the existing structures together with all contents thereof . . . shall be at the sole risk of the Employer as regards loss or damage by fire . . . and the Employer shall maintain adequate insurance against those risks'. The House of Lords held that the risk of damage to the property by fire (including fire caused by the negligence of Wimpey) had been allocated to SSHA and that therefore Wimpey were not liable for the damage caused. As Lord Keith observed, the essential question which clause 20(C) sought to answer was – who should insure against the contractor's negligence? The answer was that it was SSHA. Two puzzles emerge from this case. The first is that the House of Lords did not apply the *Canada Steamship* rules of construction to the clause (see 11.6), notwithstanding the fact that the *effect* of this clause was to enable Wimpey to exclude liability for the consequences of their own negligence. Thus the clause was held to exclude liability for negligence, even though the word negligence was not mentioned in the clause. Nor did the House of Lords consider whether there was any alternative source of liability to which the clause could apply – they simply sought to give the clause its natural interpretation. Welcome as this approach is (see 11.6), it does not explain why the *Canada Steamship* rules were not invoked. The second puzzle relates to the applicability of UCTA. For procedural reasons, the Act was not

in issue before the court. But would the clause have fallen within the scope of the Act? It can be argued that such clauses do not fall within its scope because they seek to allocate risk and the responsibility for insurance and do not seek to 'exclude or restrict a liability'. They are clauses which allocate responsibility or which define the obligations of the parties. But there are competing arguments. In the first place we have already noted that s.13(1) extends the scope of s.2 to certain duty-defining clauses. Secondly, the *effect* of the clause was to enable one party to exclude liability for the consequences of its own negligence. In deciding whether such clauses fall within the scope of the Act, much will depend upon whether the courts examine the form of the clause or its substance. If they examine its form it can be argued that this is an 'insurance clause' which regulates risk and the responsibility for taking out insurance and so falls outside the scope of the Act. But if they have regard to its substance, they are more likely to conclude that it falls within the scope of the Act.

This 'form or substance' debate is of great significance for the future of the Act. The courts have not made it clear which approach they will follow. In *Johnstone* v. *Bloomsbury Health Authority* [1992] QB 333, 346, Stuart-Smith LJ, relying in part upon the judgment of Slade LJ in *Phillips* v. *Hyland* (above), stated that 'when considering the operation of section 2 of the Act the court is concerned with the substance and not the form of the contractual provision'. On the other hand, it must be said that *Phillips* itself would appear to have fallen foul to reasoning of form rather than substance, as can be seen when *Phillips* is compared with *Thompson* v. *Lohan Plant Hire* (above). The issue therefore remains to be resolved by the courts, notwithstanding its importance for the future of the Act (see further 11.16).

11.11 Liability for Breach of Contract

The Act also regulates clauses which seek to exclude or restrict liability for breach of contract. The principal section which performs this role is section 3. However, by virtue of s.3(1), this section applies only to two types of contract. The first is where one party 'deals as consumer', which is defined in s.12 in the following terms:

> '(1) A party to a contract "deals as consumer" in relation to another party if –
>
> (a) he neither makes the contract in the course of a business nor holds himself out as doing so; and

> (b) the other party does make the contract in the course of a business; and
> (c) in the case of a contract governed by the law of sale of goods or hire-purchase, or by section 7 of this Act, the goods passing under or in pursuance of the contract are of a type ordinarily supplied for private use or consumption.
>
> (2) But on a sale by auction or by competitive tender the buyer is not to be regarded as dealing as consumer.
>
> (3) Subject to this, it is for those claiming that a party does not deal as consumer to show that he does not.'

A contract is only made 'in the course of' a business where it forms part of the regular course of dealing of that business (*R & B Customs Brokers Ltd* v. *United Dominions Trust Ltd* [1988] 1 WLR 321).

The second type of contract to which s.3 applies is where one party 'deals . . . on the other's written standard terms of business'. No definition is provided of this phrase. A number of questions arise here. Does the requirement that the terms be 'written' exclude a contract which is partly written and partly oral? How much of a variation is needed before the terms applied cease to be 'standard'? What is meant by the word 'deals'? And, finally, what does the word 'other's' mean? The courts have recently begun to provide answers to these questions. The first question awaits judicial resolution but the other three questions have been considered by the courts and we shall discuss them in turn.

The first relates to the meaning of the word 'standard'. This was considered by Judge Stannard in *Chester Grosvenor Hotel Co Ltd* v. *Alfred McAlpine Management Ltd* (1991) 56 Build LR 115, 131. He stated that the question was 'one of fact and degree' and continued:

> '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.'

This pragmatic approach has much to commend it and it will reduce the ability of parties effectively to contract out of s.3 by regularly changing their standard terms in minor respects. It is not the case that all contract

terms have to be fixed in advance before the contract can be considered 'standard' but the greater the negotiation of important terms of the contract, the more likely it is that the contract will fall outside the scope of s.3 (*The Flamar Pride* [1990] 1 Lloyd's Rep 434; *The Salvage Association* v. *CAP Financial Services Ltd* [1995] FSR 655).

The second issue relates to the meaning of the word 'deals'. It has been held that it means '"makes a deal", irrespective of any negotiations that may have preceded it'. Thus negotiations over standard terms of business do not of themselves take the case outside the scope of s.3 provided that the contract is in fact entered into on those standard terms (*St Albans City and District Council* v. *International Computers Ltd* [1996] 4 All ER 481, 491).

The third issue relates to the meaning of the word 'other's'. 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. The defendants successfully argued that section 3 of the Act did not apply to an exclusion clause contained in the contract on the ground that the claimants had failed to prove that these terms were *the defendants'* written standard terms of business. This conclusion is obviously one of great significance for Model Forms of contract which are prevalent in industries such as the construction industry. It may be the case that these Forms now fall completely outside the scope of section 3. Judge Bowsher did suggest that it might be possible to prove that a defendant has by practice or by express statement adopted a Model Form as his standard terms of business but he expressly left open the question whether such proof, either alone or with other features, would make section 3 applicable in such a case. In many ways this conclusion is a surprising one because it takes so many contracts outside the scope of section 3, and the only beneficiary of this restrictive approach to the interpretation of the section is an exclusion or limitation clause which would not pass the reasonableness test. Had Judge Bowsher adopted a more liberal approach to the interpretation of 'other's' so that it encompassed Model Form contracts, it would not have resulted in the automatic invalidation of exclusion clauses contained in such Forms. All that would have happened is that they would have been subjected to the reasonableness test in the usual way. As it is, it would appear to be the case that those responsible for the drafting of Model Forms contracts no longer have to worry about the reasonableness of an exclusion or limitation clause, at least as far as section 3 of the Act is concerned.

Once over the s.3(1) hurdle we come to the substance of the section. Section 3(2)(a) is relatively straightforward, but s.3(2)(b) is more

problematic. As against the party who deals as consumer or deals on the other's written standard terms of business, the other party cannot by reference to any contract term 'when himself in breach of contract, exclude or restrict any liability of his in respect of the breach except in so far as the contract term satisfies the requirement of reasonableness' (s.3(2)(a)). Note that liability once again means business liability and that the subsection is cast in defensive terms, that is to say it assumes the existence of a breach of contract. This time, however, s.13(1) is not available to apply to duty-defining clauses because it states that it only extends the scope of sections 2 and 5–7 of the Act.

Duty-defining terms may, however, be caught by s.3(2)(b) which states that the other party cannot by reference to any contract term 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 the contract term satisfies the requirement of reasonableness.

This subsection must apply to situations other than a breach of contract because, if there was a breach of contract, it would be caught by s.3(2)(a). The type of situation the draftsman would appear to have in mind arises where a holiday company reserves the right to change the destination of the holiday or the hotel booked (without breaking the contract) and the alternative which it provides is less than the other contracting party reasonably expected. But how can a court identify the other party's 'reasonable expectations'? Presumably the exclusion clause will be ignored in identifying his reasonable expectations, but how many other terms will be disregarded in identifying his reasonable expectations? Some indication of the potential scope of the subsection was provided by the Court of Appeal in the important case of *Timeload Ltd* v. *British Telecommunications plc* [1995] EMLR 459. Clause 18 of the contract gave to BT the right 'at any time' to terminate the contract between the parties on giving one month's notice. The claimants argued that the clause fell within the scope of s.3(2)(b). BT argued that the claimants could not reasonably expect that which the contract did not purport to offer, that is to say, the enjoyment of the service for an indefinite period. But Sir Thomas Bingham MR stated that

> '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.'

Perhaps as important, he stated that, even if the case did not fall within the precise terms of s.3(2), the subsection could nevertheless be used as a 'platform for invalidating or restricting the operation of an oppressive clause in a situation of the present, very special, kind' (contrast the approach of the House of Lords in *National Westminster Bank plc* v. *Morgan* [1985] AC 686, where Lord Scarman, far from perceiving the Act as a kind of spring-board, was of the opinion that the courts should draw back now that Parliament has intervened, see further 17.5). This expansive interpretation of s.3(2)(b) is questionable. There was nothing particularly onerous about the clause in issue in *Timeload*: it gave to both parties the right to terminate the contract on the giving of a period of notice. If the courts are to place so little emphasis upon the terms of the contract in identifying the expectations of the parties, then it is difficult, if not impossible, to identify the limits of the subsection. It will have a very broad reach.

The Act also regulates other terms which seek to exclude or restrict liability for breach of contract. In contracts for the sale or hire-purchase of goods, the implied terms as to title cannot be excluded or restricted by reference to any contract term (s.6(1)); and the sellers' implied undertakings as to the conformity of goods with the description or sample, or as to their quality or fitness for a particular purpose, cannot be excluded or restricted by reference to any contract terms as against a person dealing as consumer, although as against a party dealing otherwise than as consumer the latter liabilities can be excluded or restricted by reference to a contract term only in so far as the term satisfies the requirement of reasonableness (s.6(2),(3)). Two additional points should be noted here. The first is that all attempts to exclude or restrict these implied terms are caught by UCTA, not simply those which seek to exclude or restrict a business liability under s.1(3) (s.6(4)). It should, however, be remembered that the implied terms relating to quality and fitness for purpose apply only where the seller sells the goods in the course of a business (see 9.8). The second is that the Act directs the courts to have regard to specific matters in considering whether such a term is reasonable (s.11(3) and Schedule 2).

In the case of a contract of hire or a contract of exchange, any term of the contract which purports to exclude or restrict liability for breach of an obligation arising by implication from the nature of the contract in

respect of the goods' correspondence with their description or sample or their quality and fitness for any particular purpose is void as against a consumer (s.7(2)) and, as against anyone else, must satisfy the reasonableness test (s.7(3)). Liability for breach of the obligations contained in s.2 of the Supply of Goods and Services Act 1982 cannot be excluded or restricted by reference to any contract term (s.7(3A)), and liability in respect of the right to transfer ownership of the goods or give possession or the assurance of quiet possession to a person taking goods in pursuance of the contract cannot be excluded or restricted by reference to any such term except in so far as the term satisfies the requirement of reasonableness (s.7(4)).

11.12 Indemnity Clauses

An indemnity clause is a clause under which one contracting party promises to indemnify (that is to say, reimburse) the other for any liability incurred by him in the performance of the contract. Section 4 of the Act regulates indemnity clauses. Section 4(1) states that any person dealing as consumer cannot be required, as a term of the contract, to indemnify another in respect of liability that may be incurred by that other for negligence or breach of contract, except to the extent that the term satisfies the requirement of reasonableness. This section only applies where the party required to give the indemnity deals as consumer (see s.12, above). It has no application to commercial indemnity clauses. This point helps to explain some of the difficulties which arose in *Phillips* v. *Hyland* (above) and *Thompson* v. *Lohan Plant Hire* (above). Both of these cases essentially involved commercial indemnity clauses. But, because s.4 does not extend to such clauses, it was necessary to invoke s.2 in an effort to bring them within the scope of the Act.

11.13 Attempts at Evasion

The Act contains a number of controls upon attempts to evade the application of the Act. Two are worthy of note here. The first is s.13(1), the existence of which we have already had cause to note (see 11.10). The subsection states:

> 'To the extent that this Part of this Act prevents the exclusion or restriction of ány liability it also prevents

(a) making the liability or its enforcement subject to restrictive or onerous conditions;
(b) excluding or restricting any right or remedy in respect of the liability, or subjecting a person to any prejudice in consequence of his pursuing any such right or remedy;
(c) excluding or restricting rules of evidence or procedure;

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

The principal point which should be noted is that this subsection does not have independent effect: its function is to extend the scope of sections 2 and 5–7. It does not, of itself, render any contract term void, nor does it subject any contract term to the reasonableness test. That task is performed by sections 2 and 5–7 and a court ought always to refer back to whichever of these sections is applicable when applying the reasonableness test or declaring that the term is void. We have already noted that s.13(1) is open to criticism in that it fails to provide any guidance as to the extent to which it applies to duty-defining clauses (see 11.10). But, in other respects, the extensions which it makes are useful ones. For example, purporting to exclude a right of set-off falls within its scope (*Stewart Gill Ltd* v. *Horatio Myer & Co Ltd* [1992] QB 600) as would setting a short time-limit within which a claim must be made or excluding a particular remedy (such as termination) while leaving other remedies (such as damages) intact.

The second section which is worthy of note in this connection is section 10, which states that a term excluding or restricting liability, which is contained in a separate contract rather than in the contract giving rise to the liability, is ineffective in so far as it attempts to take away a right to enforce a liability which under the Act cannot be excluded or restricted. The mischief at which the section is aimed is the practice of seeking to evade the Act by the use of another contract, for example where a term in a contract between a manufacturer of a product and a purchaser purports to affect the rights of the purchaser against the vendor under the Sale of Goods Act 1979. The section therefore applies to attempts to evade the provisions of the Act by the introduction of an exclusion clause in a contract with a third party, but it does not apply to genuine compromises of existing claims (*Tudor Grange Holdings Ltd* v *Citibank NA* [1992] Ch 53).

11.14 The Reasonableness Test

The reasonableness test is central to the operation of the Act and therefore requires separate discussion. Section 11(1) provides that

> 'in relation to a contract term, the requirement of reasonableness . . . 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.'

It is important to note that reasonableness is to be assessed at the date of making the contract, not the date of breach. The onus lies on the party relying on the exclusion clause to show that it is reasonable (s.11(5)). The courts have taken into account a number of factors in deciding whether an exclusion clause is reasonable: the respective bargaining power of the parties, whether the exclusion clause was freely negotiated, the extent to which the parties were legally advised, the availability of insurance, the availability of an alternative source of supply to the innocent party and the extent to which the party seeking to rely on the exclusion clause sought to explain its effect to the other party (see also the factors listed in Schedule 2 to the Act which the court is specifically directed to take into account in the case of a contract which falls within the scope of sections 6 or 7 of the Act).

An example of the operation of the reasonableness test can be provided by reference to the case of *Phillips* v. *Hyland* (discussed above, 11.10). There it was held that condition 8 of the contract failed the reasonableness test because the claimants did not generally hire JCB excavators and their drivers, the hire was for a very short period of time, there was little opportunity for the claimants to arrange any insurance cover and the claimants had no control over the choice of driver. The defendants were in the best position to take out insurance and to bear the loss. All these factors combined to suggest that condition 8 was not reasonable. But the question of the reasonableness of a particular clause is a highly discretionary one and the courts have not been wholly consistent in the exercise of their discretion. Some judges have been more interventionist than others (see Adams and Brownsword, 1988a). The consequence of this is an element of unpredictability and inconsistency in the case law. Appellate courts have largely abdicated their role as the guardians of predictability and consistency by holding that an appellate court must treat the trial judge's finding on the issue of reasonableness with the utmost respect and refrain from interference unless satisfied that

the lower court proceeded on some 'erroneous principle or was plainly and obviously wrong' (*George Mitchell (Chesterhall) Ltd* v. *Finney Lock Seeds* [1983] 2 AC 803). Given this approach, it is likely that inconsistency will continue to be a feature of cases decided under the reasonableness test of UCTA and, to that extent, the interest in preserving commercial certainty has been sacrificed.

Although much depends upon the facts of the individual case, there are a number of propositions which can be advanced with a degree of certainty. The first is that the court will have regard to the clause as a whole in deciding whether or not it is reasonable: the court does not have regard only to that part of the clause which is being relied upon by the party seeking to exclude or restrict liability (see *Stewart Gill Ltd* v. *Horatio Myer & Co Ltd* [1992] QB 600). This proposition flows from the fact that s.11(1) states that the time for assessing the reasonableness of the clause is the time at which the contract was made (at which point it will not be known which part of it will be relied upon by the defendant) and not the time of the breach. The second point is that the court does not have the power to sever the unreasonable parts of an exclusion clause from the reasonable parts, leaving the latter in force (*Stewart Gill Ltd* v. *Horatio Myer & Co Ltd* (above)). This conclusion has important drafting consequences. It is now extremely unwise to rely upon a single all-embracing exclusion clause because, should it go too far at one particular point, it may fail in its entirety. It is much safer to separate out the different elements of the clause into sub-clauses so that a failure of one part will not necessarily invalidate the entire clause.

The third point relates to the importance of 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. Fourthly, it is clear that the insurance consequences of the clause should always be clearly brought before the court. It is the availability of insurance at the time at which the contract was concluded which is important, not the actual insurance position of the parties (see *The Flamar Pride* [1990] 1 Lloyd's Rep 434). Thus the fact that the defendant has chosen to insure itself for a sum substantially in excess of the limitation clause in the contract does not of itself establish that the limitation clause is unreasonable (*Moores* v. *Yakeley Associates Ltd* (1999) 62 Con LR 76). Fifthly, contracting parties should abandon widely-drafted exclusion clauses. In particular, the courts are unlikely to look favourably upon exclusion clauses which undermine the express promises which have been made under the contract (see *Lease Management Services Ltd* v. *Purnell Secretarial Services* Ltd [1994] Tr LR 337).

The sixth point relates to the way in which the clause is enforced in

practice. The fact that the defendant has not always enforced the clause in practice does not mean that the clause is inevitably unreasonable. In *Schenkers Ltd* v. *Overland Shoes Ltd* [1998] 1 Lloyd's Rep 498 the Court of Appeal, in finding a clause to be reasonable, had regard to the fact that the clause was in common use and was well known and that there was no significant inequality of bargaining power between the parties, and concluded that in that context the give-and-take practised by the parties, where the clause was not rigorously enforced, did not prevent the claimants from relying on the clause. The position is otherwise where there is a recognition in the industry that reliance on the clause is unreasonable. In such a case, a court is likely to infer from the fact that the clause was not enforced in practice that this was because the clause was unreasonable (see *George Mitchell (Chesterhall) Ltd* v. *Finney Lock Seeds Ltd* [1983] 2 AC 803).

The seventh point is that it is not 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 claimants' goods as they were required to do under the terms of the contract. The defendants' liability was limited to £600. It was held that, while a limitation of £600 would have been reasonable for a claim for direct loss suffered by the claimants (for example, caused by the default of the defendants when transporting the goods), it was not reasonable for a failure to insure. The reason for this conclusion is to be found in the different consequences which flow from the two breaches. A failure to insure the goods meant that the claimants could only recover £600 from the defendants, whereas, had the goods been insured but damaged as a result of the default of the defendants, the claimants could have recovered the first £600 of their loss from the defendants and the balance from their insurance policy. In seeking to include two very different losses within the same limitation clause, the defendants made it very difficult for themselves to show that the limitation clause was reasonable and, indeed, on the facts they failed to do so and they were liable to the claimants in the sum of £8500.

The final point relates to the advantages which can be obtained by the use of limitation clauses rather than exclusion clauses. In many cases a sensibly drawn limitation clause is more likely to pass the reasonableness test than a total exclusion of liability. But there is no guarantee that it will pass. In *St Albans City and District Council* v. *International Computers Ltd* [1996] 4 All ER 481 a clause in a computer contract which limited liability to £100,000 was held to be unreasonable. In that case, the trial judge ([1995] FSR 686), whose judgment was upheld by the Court of Appeal, attached importance to the fact that the parties were of unequal

bargaining power, the defendants had not justified the figure which they had inserted into the contract, the defendants were insured and he thought that the party who stood to make the profit (the defendants) should also take the risk of loss. It would seem that, where a limitation clause is inserted into the contract, an attempt should be made to provide some objective justification for the selection of that figure (in terms of the turnover of the party relying on the clause, the insurance cover available, the value of the contract or the financial risk to which the claimants are exposed). A failure to adduce such evidence might incline a court towards the conclusion that the clause is unreasonable (see *The Salvage Association* v. *CAP Financial Services Ltd* [1995] FSR 655).

11.15 Excepted Contracts

Finally, it should be noted that the Act does not apply to certain contracts, such as contracts of insurance, contracts which concern the transfer of an interest in land and international supply contracts (see generally Schedule 1 and s.26).

11.16 Conclusion

The Unfair Contract Terms Act 1977 is a major attempt to regulate the use of exclusion clauses in Britain. It cannot claim to be a wholly satisfactory piece of legislation. The main difficulty still lies in identifying the essential nature of an exclusion clause: does it define the nature and extent of the contractual obligation or is it a defence to a breach of an obligation? As we have noted, the courts have traditionally seen exclusion clauses in defensive terms and, although UCTA is cast primarily in defensive terms, s.13(1) and s.3(2)(b) do extend the Act to certain duty-defining clauses. But, once it is conceded that the Act does apply to duty-defining clauses, on what basis can it be decided which duty-defining terms are caught by the Act and which are not? This has become a question of some importance as contract draftsmen have sought to evade the clutches of the Act. Yet it is a question to which those who support the defensive view of exclusion clauses have provided no answer.

It is suggested that the only solution, however unpalatable it may be, lies in a reconsideration of the whole basis of the Act, in recognising that exclusion clauses perform duty-defining functions and treating them like any other term of the contract and only intervening to control them where they are shown to be 'unfair' or 'unconscionable'. An opportunity to re-

consider the Act was presented by the EC Directive on Unfair Terms in Consumer Contracts (see 1.6 and 17.6). Clauses which seek to exclude or restrict liability fall within the scope of the Directive (see the Annex, paragraphs (a) and (b)) but so do many other contract terms which are unfair. Unfortunately, the Directive was implemented into domestic law by means of a statutory instrument (Unfair Terms in Consumer Contracts Regulations, SI 1994, No. 3159 which was re-enacted with modifications in the Unfair Terms in Consumer Contracts Regulations 1999, SI No. 2083) and UCTA was not amended in any way. Instead, consumers have been given rights under the Regulations in addition to their existing rights under UCTA (the scope of the two rights is compared at 17.6). This is unfortunate. The Directive provided English law with an opportunity to reconsider the basis of UCTA and the piecemeal approach to regulation which it adopts. The jurisdictional problems which we have noted in this chapter would have been significantly reduced, if not eliminated, by the adoption of a more general test of unfairness. Sadly, English law has passed up the opportunity to reconsider the Act and the problems which we have noted will continue unabated.

Summary

1 Exclusion clauses may be seen either as defining the obligations of the parties or as a defence to a breach of an obligation. The latter is the view which the courts have primarily adopted.
2 Exclusion clauses must be validly incorporated into the contract. Incorporation may take place either by the party who is not relying on the exclusion clause signing the contract containing the exclusion clause, by giving reasonable notice of the exclusion clause to that party or by a course of dealing.
3 The exclusion clause, properly interpreted, must cover the damage which has arisen. The general rule of construction is that the exclusion clause will be interpreted *contra proferentem* (that is, against the party seeking to rely on the exclusion clause).
4 In relation to an attempt by a contracting party to exclude liability for his own negligence, three specific rules have been devised by Lord Morton in *Canada Steamship Lines Ltd* v. *The King*. However, these rules are only aids to be used by the court in identifying the intention of the parties.
5 The doctrine of 'fundamental breach' is a rule of construction, according to which the more serious the breach, or the consequences of the breach, the less likely it is that the court will interpret the exclusion clause as covering the breach.
6 The Unfair Contract Terms Act 1977 is now the major source of control of exclusion clauses.
7 Attempts by reference to a contract term or notice, to exclude or restrict liability for negligence causing death or personal injury are void. In relation to other loss or damage caused by negligence, such attempts are only valid if they are held to be reasonable.
8 Where one party deals as consumer or on the other's written standard terms of

business, the other party cannot exclude or restrict liability for his own breach of contract or claim to be entitled to render a contractual performance substantially different from that which was reasonably expected of him or render no performance at all, except in so far as the contract term satisfies the requirement of reasonableness.

9 Reasonableness is to be assessed as at the date of making the contract and the onus is upon the party relying on the exclusion clause to show that it is reasonable.

10 The court has a wide discretion in deciding whether or not an exclusion clause is reasonable and will consider a number of different factors in reaching its conclusion.

Exercises

Consider the example involving Peter and John set out at 11.1 on the assumption that it includes the following exclusion clause: 'no liability is accepted for any damage, howsoever caused, to goods during the course of transit'.

1 What is the function of such a clause?
2 Peter wishes to know how he can incorporate such a clause into his contracts. How would you advise him?
3 Does the exclusion clause cover the damage done in the following cases?
   (i) Some of John's furniture is damaged as it is loaded into Peter's van;
   (ii) John's furniture is damaged when Peter's van crashes because of Peter's negligent driving;
   (iii) John's furniture is totally destroyed when Peter's van is destroyed by fire;
   (iv) Peter sells John's furniture before he gets to Preston.
4 How does the Unfair Contracts Terms Act 1977 affect the exclusion clause in the situations described in question 3(i)–(iv)?