ASSESSING THE REASONABLENESS OF EXCEPTION CLAUSES

In consumer as well as in business-to-business contracts, exception clauses are used to allocate risk and liability in the event of a breach. The validity of such clauses turns upon issues of incorporation and construction and, where the English Unfair Contracts Terms Act 1977 ("UCTA") applies, the satisfaction of the requirement of reasonableness. While the first two issues have received considerable discussion in Singapore cases, there is a dearth of authority on the third requirement, notwithstanding that it was affirmed in 1993 that UCTA applies in Singapore. The issue of reasonableness or fairness, however, has been widely considered, particularly in England and in a few other common law jurisdictions. Although courts must be given a wide discretion to determine what is reasonable on a case-by-case basis, the guidelines formulated in other jurisdictions may serve as broad points of reference. This article will focus on the requirement of reasonableness and suggest the broad criteria that may be applicable in appropriate cases.

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I. Introduction

1 Exception clauses are commonly found in contracts across all industries. Their function is to shift all or some of the risks of loss to the non-breaching party as a cost-effective measure in the event of a breach. This is achieved by means of either a total exclusion or a limitation of liability clause as the case may be. Generally speaking, the court may regard clauses which restrict liability with less hostility as these are more likely to accord with the intention of the parties that some liability should attach in the event of a breach.[1]

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1 *PT Soonlee Metalindo Perkasa v Synergy Shipping Pte Ltd* [2007] 4 SLR(R) 51; *Sim Jwee Kiat v City Car Rentals & Tours Pte Ltd* [1990] 2 SLR(R) 110; *The Neptune*

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2 The approach to business-to-business contracts is to presume that commercial parties are of equal bargaining power and aware of the business risks and how these might be insured against. Hence, it makes economic and commercial sense to provide for exception clauses in commercial contracts and to factor them into the contract price so as to reduce business costs. Thus, if commercial parties enter into a low-cost contract and agree to exclude liability, then the non-breaching party has elected to bear the risk of loss in return for paying a lower price. This will be a relevant factor in persuading the court to adopt a non-interventionist policy, consistent with the basic principle of freedom of contract. This principle is based on the assumption that parties are of equal bargaining power, negotiate on an equal footing and have a full understanding of the terms of the contract and their legal effect. This was reiterated by Chadwick LJ in *Watford Electronics Ltd v Sanderson CFL Ltd*[2] in these terms:

> [Experienced businessmen] … should be taken to be the best judge on the question whether the terms are reasonable. The court should not assume that either is likely to commit his company to an agreement which he thinks is unfair, or which he thinks includes unreasonable terms. Unless satisfied that one party has, in effect, taken unfair advantage of the other – or that the term is so unreasonable that it cannot have been understood or considered – the court should not interfere ….

3 In reality, the principle of freedom of contract should not apply where the other contracting party is perceived to be the weaker party as in the case of consumers or even small businesses. Thus, where the particular circumstances of a case so warrant, courts are willing to strike down exception clauses in order to ensure that the party in breach should not get off scot-free.

4 Where the validity of an exception clause is in issue, the court will first determine whether the clause has been properly incorporated into the contract,[3] and if so, whether or not, upon its true construction, it applies to the breach in question.[4] The Singapore court has no general

Argate [1994] 3 SLR(R) 272; *Ailsa Craig Fishing Co Ltd v Malvern Fishing Co Ltd; Malvern Fishing Co Ltd v Ailsa Craig Fishing Co Ltd* [1983] 1 WLR 964.

2 [2001] EWCA Civ 317.

3 Examples of Singapore cases include *Jet Holding Ltd v Cooper Cameron (Singapore) Pte Ltd* [2005] 4 SLR(R) 417; *Hakko Products Pte Ltd v Danzas (Singapore) Pte Ltd* [1999] 1 SLR(R) 651; *Press Automation Technology Pte Ltd v Trans-Link Exhibition Forwarding Pte Ltd* [2003] 1 SLR(R) 712; *Trans-Link Exhibition Forwarding Pte Ltd v Wadkin Robinson Asia Pte Ltd* [1996] 1 SLR(R) 424.

4 *Zurich Insurance (Singapore) Pte Ltd v B-Gold Interior Design & Construction Pte Ltd* [2008] 3 SLR(R) 1029 is a significant case affirming the Singapore courts' move towards a contextual approach in contractual interpretation which requires contracts to be interpreted against the background in which they were entered into. See V K Rajah, "Redrawing the Boundaries of Contractual Interpretation – From

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power to strike down an exception clause for being unreasonable except under the Unfair Contract Terms Act ("UCTA"),[5] although it may achieve the same result as a matter of construction. The question of reasonableness is the most difficult issue of all as much turns on the facts of the case and upon the discretion of the judge. Singapore courts rarely encounter this issue due to the fact that exception clauses are usually struck down at the incorporation or construction stage.

II. Scope of UCTA and the requirement of reasonableness

5 It is well known that the title of the Act is a misnomer. It does not deal with the fairness of contract terms in general but regulates only exception clauses in certain types of contracts[6] by striking down certain exception clauses and subjecting others to the test of reasonableness. UCTA applies to both consumer ("B2C") and business-to-business ("B2B") contracts and also to terms or notices excluding certain liability in tort. Section 2 addresses the restriction or exclusion of negligence liability by reference to any contract term or to a notice given generally or to specified persons. Such a term or notice cannot exclude or restrict liability for death or personal injury resulting from negligence. For other loss or damage, liability cannot be excluded or restricted unless the term or notice satisfies the requirement of reasonableness.

Text to Context to Pre-Text and Beyond" (2010) 22 SAcLJ 513. Examples of other cases include *Smart Modular Technologies Sdn Bhd v Federal Express Services (M) Sdn Bhd* [2006] 2 SLR(R) 797 (the appeal against this decision was dismissed by the Court of Appeal); *Singapore Telecommunications Ltd v Starhub Cable Vision Ltd* [2006] 2 SLR(R) 195.

5 Cap 396, 1994 Rev Ed. The English Unfair Contract Terms Act 1977 (c 50) (UK) applies in Singapore by virtue of the Application of English Law Act (Cap 7A, 1994 Rev Ed). It must be noted that the English Unfair Terms in Consumer Contracts Regulations 1999 do not apply in Singapore as they were enacted pursuant to the EU Directive on Unfair Terms in Consumer Contracts. The purpose of this is to protect consumers against one-sided contracts favouring businesses. The Regulations do not amend the Unfair Contract Terms Act but provide an additional set of controls.

6 Section 4 of the Unfair Contract Terms Act (Cap 396, 1994 Rev Ed) regulates commercial indemnity clauses, s 3 deals with consumer and written standard terms contracts, and ss 6 and 7 with sale of goods and related contracts. The Act specifically excludes certain types of contracts from its ambit: s 26 in relation to an international supply contract where (i) it is a contract of sale of goods or it is one under which the possession or ownership of goods passes and (ii) it is made by parties whose places of business (or if none, their habitual residences) are in the territories of different states provided:

> (a) the goods in question are, at the time of the conclusion of the contract, in the course of carriage, or will be carried, from one State to another; (b) the acts constituting the offer and acceptance have been done in the territories of different States; or (c) the contract provides for the goods to be delivered to the territory of a State other than that within whose territory those acts were done.

6 Under s 3(2), the party relying on the clause (*proferens*) cannot (a) exclude or restrict liability for breach; or (b) claim to be entitled to render a contractual performance substantially different from that which was reasonably expected of him; or (c) render no performance at all in respect of the whole or any part of his contractual obligation except in so far as the contract term satisfies the test of reasonableness. Section 3[7] applies where one party deals as a consumer[8] or on the other's written standard terms of business. Notwithstanding that standard form contracts can be used to promote standards in commercial dealings and reduce transaction costs, this is outweighed by the need to protect the presumably weaker party, the consumer or a small business, confronted with a "take it or leave it" standard form contract containing exception clauses which may be unfair or one-sided. The vital question whether or not a contract is "standard" so as to bring it within the scope of s 3 was considered in *Yuanda (UK) Co Ltd v WW Gear Construction Ltd.*[9] Edwards-Stuart J concluded[10] that "the conditions have to be standard in that they are terms which the company in question uses for all, or nearly all, of its contracts of a particular type without alteration". He also agreed with Judge Forbes[11] on the relevance of the following factors in deciding whether a particular set of terms may constitute a party's standard terms of business: (a) the degree to which the standard terms are considered by the other party as part of the process of agreeing to the terms of the contract; (b) the degree to which the standard terms are imposed by the *proferens* on the other party; (c) the degree to which the *proferens* is prepared to entertain negotiations with regard to the terms of the contract generally and the standard terms in particular. He attached much importance to the final factor and concluded that the difference between the proferred terms and the final concluded terms must be significant. The present case was not one in which the claimant had dealt on the other's written standard terms of business for the following reasons: (a) the claimants negotiated some material alterations to the proferred standard terms and so could not be said to

7 The Singapore case of *United Overseas Bank Ltd v Mohamed Arif* [1994] 1 SLR(R) 530 clearly distinguished an exclusion clause from a contractual term which did not fall within s 3 of the Unfair Contract Terms Act 1977 (c 50) (UK). The "exclusion clause" in the margin trading agreement which provided that "the bank would incur no liability for failure to act on its customer's oral instructions" simply provided, as a term of the contract, that the bank was not obliged to act on oral instructions. In not acting on such instructions, the bank was not in breach of contract.

8 Defined in s 12 of the Unfair Contract Terms Act (Cap 396, 1994 Rev Ed). See, *eg*, *St Albans City and District Council v International Computers Ltd* [1996] 4 All ER 481; *The Flamar Pride* [1990] 1 Lloyd's Rep 434; *The Salvage Association v CAP Financial Services Ltd* [1995] FSR 654.

9 [2010] EWHC 720 (TCC).

10 After referring to the judgment of Judge Seymour in *Hadley Design Associates v Westminster* [2003] EWHC 1617 (TCC).

11 In *Salvage Association v CAP Financial Services Ltd* [1995] FSR 654.

have dealt on the other's standard terms of business; (b) while the terms proferred could be said to be standard, few of the contracts involved had been concluded on the same terms.

7 With regard to consumer contracts, UCTA "plays a very important role in protecting vulnerable consumers from the effects of draconian contract terms".[12] It provides in s 6 that in consumer sale and hire-purchase contracts, liability for breach of seller's/hirer's obligations as to title, conformity with description or sample and quality or fitness for a particular purpose, cannot be excluded or restricted by reference to any contract term. In business-to-business sales and hire-purchase contracts, the obligation as to title cannot be excluded or restricted. Other obligations can be excluded or restricted but only in so far as the term satisfies the requirement of reasonableness. Reasonableness means that "the contract term must have been a fair and reasonable one 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" (s 11(1)) and not when it was breached. The onus is on the *proferens* to show that it is reasonable. UCTA, however, does not formulate any specific definition of reasonableness as the requirement could vary from case to case. Instead, it provides certain guidelines for certain situations. Where the clause restricts liability to a specified sum of money, s 11(4) requires the court to have regard to available resources and insurance in determining the issue of reasonableness. Section 11(2) provides in Schedule 2 general guidelines for the application of the test for sale of goods and hire-purchase business-to-business contracts, even though the English courts have been willing to apply them more widely in other contexts.[13] This gives the courts a wide discretion to assess the reasonableness of an exception clause in the context of a particular case.

8 This article will now examine the various approaches to the question of reasonableness that have been adopted in common law jurisdictions.

III. Singapore

9 The first case to give some insight into the criteria used in upholding the exclusion clause is *Metro (Pte) Ltd v Wormald Security (SEA) Pte Ltd*[14] ("*Metro*"). Metro engaged Wormald Security to install

12 *Granville Oil and Chemicals Ltd v Davies Turner and Co Ltd* [2003] EWCA Civ 570 at [31] *per* Tuckey LJ.

13 *Levison v Patent Steam Carpet Cleaning Co Ltd* [1977] 3 WLR 90; *Rees Hough Ltd v Redland Reinforced Plastics Ltd* (1984) 27 BLR 141 at 151; *Steward Gill Ltd v Horatio Myer & Co Ltd* [1992] QB 600 at 608.

14 [1981–1982] SLR(R) 126. It is apparent that the Singapore court, starting from this case, rejected the rule of law approach which automatically rendered an exception

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and maintain security alarm systems at their departmental store. The "Installation and Service Agreement" was for a period of 12 months at a fee of $7,086 for installation, followed by a monthly service charge of $175. The security alarm system was duly installed and went into operation. At closing time each night, the usual routine check was conducted and the alarm initiated. However, the management discovered one morning that the store had been broken into and a large quantity of merchandise worth $108,756.67 was missing. Wormald Security admitted that on the night in question, it had received the relevant alarm signals but failed, in breach of contract, to notify the plaintiffs or the police.

10 Wormald Security resisted the plaintiffs' claim by relying on the exclusion clause in the contract. Kulasekaram J dismissed the plaintiffs claim, stating that whether the clause effectively excluded its claim was a matter of construction having regard to all the circumstances of the case. The relevant factors were that: (a) the clause was clear and unambiguous. It was in very wide terms and covered the present claim; (b) the parties were of equal bargaining power and they had freely agreed to the terms of the clause; (c) to give effect to the exclusion clause would not in any way deprive the plaintiffs' stipulations of any contractual force and reduce the contract to a mere declaration of intent only. Accordingly, the court upheld the exclusion clause.

11 *Metro* followed closely the House of Lords' approach in *Photo Production Ltd v Securicor Transport Ltd*[15] which will be discussed below.

12 In the next case of *Kenwell & Co Pte Ltd v Southern Ocean Shipbuilding Co Pte Ltd*[16] ("*Kenwell*"), the High Court outlined certain general principles relating to the requirement of reasonableness. In that case, the parties entered into a contract for the repair of equipment on the plaintiff's vessel. Kenwell signed work orders on the defendant's standard terms. Owing to delays and defective work, the vessel could not start operating until a later date. Kenwell sued the defendant for the delays and the defendant counterclaimed for outstanding payments for the repair works. Two questions arose: (a) whether the standard terms and conditions formed part of the contract between the parties; and (b) how far these terms were applicable to limit the defendant's liability for negligence to S$5,000.

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clause ineffective in the event of a fundamental breach. At the time of *Metro (Pte) Ltd v Wormald Security (SEA) Pte Ltd*, it was unclear whether the Unfair Contract Terms Act 1977 (c 50) (UK) applied at all in Singapore. This was resolved in 1993 by the Application of English Law Act (Cap 7A, 1994 Rev Ed).

15 [1980] AC 827, [1980] 1 All ER 556.

16 [1998] 2 SLR(R) 583.

13 The High Court found the defendant responsible for the delays and liable to pay compensation subject to the limitation clause. It held that on the facts, the defendant's standard conditions formed part of the contract with the plaintiff and s 3 of UCTA applied so that the limitation clause had to pass the reasonableness test. Warren Khoo J reiterated the following principles: (a) the burden of proving reasonableness lay with the defendant (the *proferens*); (b) the fact that the parties were commercial parties dealing with each other in the course of business did not *per se* satisfy the reasonableness requirement; (c) the willingness of a party to enter into a contract containing an exception clause did not prevent it from subsequently raising questions of reasonableness; (d) a provision commonly found in an industry may be reasonable by reason of its common usage but it could also be held to be unreasonable; and (e) whether a contractual term satisfied the reasonableness test depended on the facts of each case. In principle, a term found to satisfy the reasonableness requirement in one case may not satisfy it in another case. Indeed, the more unreasonable a contractual provision appeared to be, the greater was the burden on the party who sought to rely on it. On the facts of the case, the defendant had failed to adduce evidence to establish the reasonableness of the limitation clause. The plaintiff's claim was allowed subject to the defendant's counterclaim.

14 *Kenwell* is clear authority for the principle that even if a party knowingly enters into a contract with an exception clause, it can still challenge the validity of the clause under UCTA. That principle emanates from the language of the Act itself as the statute was passed to allow parties to be relieved of the burden of unfair exception clauses in contracts falling within the ambit of the Act.

15 In *Tjoa Elis v United Overseas Bank Ltd*,[17] the High Court had to deal with a clause excluding the bank from liability if the customer failed to check her statement of account and alert the bank of any discrepancy within a stated period. The bank's customer, Elis, had agreed to pay for her sister's shares by having her account debited and gave written instructions to that effect. However, she claimed the signatures on two instructions were forged. Woo Bih Li J held that the disputed signatures had been appended with her authority, and the exclusion clause was clear and wide enough to exclude the bank from liability. However, Woo J indicated that if the bank had wrongly debited the account without proper instructions, it would be unreasonable and against public policy to allow the bank to exclude liability.

17 [2003] 1 SLR(R) 747.

16 The next case of *Press Automation Technology Pte Ltd v Trans-Link Exhibition Forwarding Pte Ltd*[18] provides a very detailed and insightful analysis of the factors relevant to the issue of reasonableness. PATEC was participating in a trade conference in Bangkok and accepted Trans-Link's quotation to transport its 30,000kg press machine from Singapore to the exhibition hall in Bangkok for $12,000. The machine was shipped in good condition but sustained damage while in Trans-Link's custody in Bangkok. Subsequently, it was transported back to PATEC's warehouse in Singapore. PATEC claimed US$178,091.75 being the value of the machinery less salvage value and the cost of the survey report. The court held that the Singapore Freight Forwarder's Association ("SFFA") Conditions formed part of the contract between the parties. The contract was concluded on a party's written standard terms of business and hence s 3 of UCTA applied. Prakash J reiterated that the time for determining the reasonableness of the exception clause was the time the contract was made and not the time when it was breached and the onus for showing this was on the party relying on the clause. Although the court recognised the international practice of freight forwarders to trade on standard terms which included time bar periods and limitation of liability clauses, this was not the end of the matter because the court had to consider whether each of the disputed clauses was reasonable in the specific circumstances of the present contract. In relation to the time bar, Trans-Link failed to satisfy the court that in the circumstances of the case, it was necessary to put a nine-month time bar in place in order to protect its right of recourse against the third party carrier for goods lost or damaged whilst in its custody. The only evidence that any part of the carriage was subject to a time-bar period of less than six years related to the carriage from Singapore to Bangkok. That leg was covered by the Hague Visby Rules, and had the damage occurred while the goods were on board the *MV Asia Express*, Trans-Link would have been able to rely on r 6*bis* to extend the time in which it could claim an indemnity from the owners of that vessel and would not need the protection of a nine-month time-bar period for that purpose. Furthermore, at the material time, Trans-Link had insurance covering any liability it incurred in the course of its business. No evidence was adduced to the effect that it was a condition of the insurance cover that a nine-month time bar must be imposed. Nor was there any evidence that that particular insurance company would have charged a prohibitive rate of premium if it had been asked to cover transactions that had a longer time-bar period. There was nothing to indicate that Trans-Link was required to trade on the SFFA Conditions in order to obtain insurance cover. Accordingly, the court concluded that Trans-Link had not shown, on the balance of probabilities, that it required a nine-month time bar in order to insure itself, at reasonable rates, for liability incurred as a bailee. Trans-Link

18 [2003] 1 SLR(R) 712.

had not discharged the onus of showing that the nine-month time-bar period was reasonable in relation to the contract for the carriage of the machinery. It followed that PATEC's claim was not time barred.

17 The next issue was whether the clause restricting Trans-Link's liability in respect of any goods lost, damaged, misdirected or misdelivered to the sum of $100,000 was effective. The status of financial limitation clauses in the freight forwarding context was stated by the English Court of Appeal in *Overseas Medical Supplies Ltd v Orient Transport Services Ltd*[19] in these terms:

> [T]he fairness and reasonableness of limiting liability in each case cannot be equated. In the transport business, owner and carrier are likely to be insured. The owner's insurance, which is indemnity insurance, would be cheaper than the carrier's liability insurance. Sorting out the carrier's liability for loss can be a complex, uncertain and expensive process. Therefore, limitations or even exclusions of liability for the carrier are apt to be considered reasonable.

18 On the point of insurance, the Singapore court stated that it was PATEC's responsibility, under the terms of the contract to arrange insurance to cover the machine during transport to the exhibition, display at the exhibition and during its return voyage. Therefore, there was never the possibility that PATEC would be left without recourse for the full damage. On this basis, it was reasonable for Trans-Link to limit its liability.

19 Furthermore, the decision to engage Trans-Link was a calculated one with a view to minimising costs and in the interests of practicability and convenience given the various options available to PATEC. The court accepted Trans-Link's submission that when a party chose to engage a forwarder out of convenience and for the price, it could hardly be said that the forwarder had the superior position as alleged by PATEC. The latter did have bargaining power and it chose Trans-Link as its freight forwarder after carefully considering its other options. In light of all the circumstances of this contract, the court found the clause in question to be reasonable and allowed Trans-Link to limit its liability to $100,000.

20 More recently, in *Anti-Corrosion Pte Ltd v Berger Paints Singapore Pte Ltd,*[20] the High Court stated, *obiter,* that the limitation clause therein would have satisfied the reasonableness test under UCTA, had the paint supplied by the defendant been found to be defective. The High Court was prompted by the following considerations: that the clause was not a total exclusion clause but a limitation clause limiting liability to

19 [1999] EWCA Civ 1449 at [7].
20 [2010] SGHC 351.

replacing the goods or their replacement costs; that the parties were commercial parties with equal bargaining power; that it was understandable for the defendant to limit product liability since much could have gone wrong between the sale and application of the paint and it would be a tedious process to determine fault. These are useful indications of the factors which the Singapore court will take into consideration in assessing the reasonableness or otherwise of an exception clause.

IV. England

21 It will be recalled that *Metro* followed the English decision of *Photo Production Ltd v Securicor Transport Ltd*[21] ("*Photo Production*"), where the House of Lords rejected the rule of law approach in the case of a fundamental breach of contract and adopted instead the contractual interpretation approach.[22] Lord Wilberforce articulated the underlying policy rationale in favour of the construction approach as a matter of allowing the parties to make their own bargain.[23] He stated as follows:

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

22 Lord Diplock, concurring, articulated a similar policy reason:[24]

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

23 In upholding the exclusion clause, the House of Lords took into account the following factors: (a) the words of the exclusion clause were clear and on their true construction covered the breach in question; (b) a small fee was paid by the claimant to the security company in return for bearing the risk of loss in the event of a breach; (c) there was equality of bargaining power; (d) there was availability of insurance. The parties should therefore be free to apportion the risks as they

21 [1980] AC 827.

22 In *Internet Broadcasting Corp v MAR LLC* [2009] EWHC 844 (Ch), the High Court affirmed the construction approach but there was a strong presumption against an exemption clause being construed so as to cover a deliberate, repudiatory breach.

23 *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827 at 843.

24 *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827 at 851.

thought fit, making provision for their respective risks according to the terms they chose to agree. At the end of the day, although damages were successfully excluded by the contract, the losses were recouped from the respective insurers. Taking all these factors into consideration, the House of Lords upheld the contractual freedom of commercial parties to agree on what they thought made good business sense. There was no sound reason either on principle or policy to disturb how the parties chose to allocate the loss.

24 The action in *Photo Production* was commenced before UCTA came into force in England but the approach in that case is consistent with that envisaged by the Act. The same non-interventionist policy is evident in subsequent cases with regard to exception clauses in contracts between experienced business parties who are presumed to be of equal bargaining power:[25] *Overland Shoes Ltd v Schenkers Ltd*;[26] *Monarch Airlines Ltd v London Luton Airport Ltd*;[27] *Granville Oil and Chemicals Ltd v Davies Turner and Co Ltd*;[28] *Watford Electronics Ltd v Sanderson CFL Ltd*;[29] *Frans Maas (UK) Ltd v Samsung Electronics (UK) Ltd*;[30] *Sterling Hydraulics Ltd v Dichtomatik Ltd.*[31]

25 The House of Lords also considered the requirement of reasonableness under s 2 of UCTA in the following cases of *Smith v Eric S Bush and Harris v Wyre Forest District Council*,[32] which were handled as joint appeals. In the first case, the plaintiff approached a building society for a mortgage. The building society instructed the defendant, a firm of surveyors and valuers, to carry out a visual inspection of the house and to report on its value. The plaintiff paid the inspection fee. The report stated that no essential repairs were necessary. The mortgage application form and the valuation report contained a disclaimer of liability for the accuracy of the report covering both the building society and the valuer. The plaintiff was also informed that the report was not a structural survey and she was advised to obtain independent professional advice. The building society supplied a copy of the report to her and in reliance on it, she purchased the house without any further survey. One of the chimneys subsequently collapsed. The plaintiff claimed damages from the defendant in negligence and the latter relied, *inter alia*, on the disclaimer in the report and the application form as exempting it from

25 Where commercial parties are not of equal bargaining power, the court will strike down the clause as being unreasonable: *Motours Ltd v Euroball (West Kent) Ltd* [2003] EWHC 614 (QB).
26 [1998] 1 Lloyd's Rep 498.
27 [1997] CLC 698.
28 [2003] EWCA Civ 570.
29 [2001] EWCA Civ 317.
30 [2004] EWHC 1502.
31 [2007] 1 Lloyd's Rep 8.
32 [1989] 2 WLR 790.

liability to the plaintiff. The plaintiff argued that the disclaimer did not satisfy the requirement of reasonableness. The judge gave judgment for the plaintiff and the Court of Appeal dismissed the defendant's appeal.

26 In the second case, the plaintiffs applied to the first defendant council for a mortgage. They filled in the council's standard mortgage application form and paid the inspection fee. The form excluded the council from liability for the value or condition of the house by reason of the inspection report, and advised the plaintiffs to obtain their own survey. The council instructed the second defendant, a valuer in their employment, to carry out an inspection. He recommended a mortgage subject to certain minor repairs. The valuer's report was not shown to the plaintiffs but they were subsequently offered a mortgage by the council. Three years later, when the plaintiffs tried to sell the property, the valuer inspected the property again for the council because a prospective purchaser had applied to them for a mortgage. The survey revealed the need for structural repairs which were estimated to cost thousands of pounds. The property was regarded as uninhabitable and thus unsaleable. The plaintiffs claimed damages for the valuer's negligence as servant and agent of the council. The judge found for the plaintiffs. The Court of Appeal allowed an appeal by the defendants.

27 On appeal by the defendant in the first case and by the plaintiffs in the second case, the House of Lords dismissed the defendant's appeal in the first case and allowed the plaintiffs' appeal in the second case. It held that a valuer instructed by a prospective mortgagee to carry out a valuation of a modest house for the purpose of deciding whether or not to grant a mortgage on it to the prospective mortgagor owed a duty of care to the mortgagor to exercise reasonable skill and care in carrying out the valuation if he was aware that the mortgagor would probably purchase the house in reliance on the valuation without an independent survey, unless the valuer had made a disclaimer of liability to the mortgagor. Such disclaimer of liability by or on behalf of the valuer was a notice which purported to exclude liability for negligence within the meaning of s 2(2) of UCTA and had to satisfy the requirement of reasonableness under s 11(3) of the Act. Since the valuer was a professional man, whether or not he was employed by the mortgagee, whose services were paid for by the mortgagor, who might or might not be supplied with a copy of the valuation report, it would not be fair and reasonable to allow the valuer to rely on such a disclaimer to exclude his liability to the mortgagor for the accuracy of the valuation.

28 Lord Griffiths pointed out the four factors which must always be considered when determining the reasonableness of an exception clause. These were: (a) Were the parties of equal bargaining power? (b) How far was it reasonably practicable for independent advice to be obtained taking into account the costs and time that may be taken up in

obtaining such advice? (c) How difficult is the task being undertaken for which liability is being excluded? and (d) What are the practical consequences of the decision on the question of reasonableness?

29 Lord Griffiths' approach is apparent in the case of *St Albans City and District Council v International Computers Ltd.*[33] The plaintiff bought a computer program from the defendant and by reason of an error in the program, suffered losses of £1,314,846. The plaintiff had contracted on the defendant's written standard terms of business which included a clause limiting the defendant's liability to £100,000. The following factors were relevant in assessing whether or not the clause was reasonable: (a) the resources which the *proferens* could expect to be available to him for the purpose of meeting the liability should it arise; (b) how far it was open to him to cover himself by insurance (s 11(4)); and (c) the matters mentioned in Schedule 2 of UCTA. Taking these into account, Scott Baker J held that: (1) the parties were of unequal bargaining power; (2) the amount of £100,000 in the limitation clause was small in comparison with the potential risk and actual loss sustained; (3) the defendant was insured for an aggregate sum of £50m worldwide; (4) the practical consequences, *ie*, the *proferens* was better able to bear the loss. Accordingly, the court held that the defendant failed to prove that the limitation clause was reasonable. The Court of Appeal agreed, citing Lord Bridge's statement in *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd*[34] on the trial judge's finding on the question of reasonableness. This will be discussed below.

30 The same approach is evident in the recent case of *Lobster Group Ltd v Heidelberg Graphic Equipment Ltd.*[35] The first defendant sold a printing press to the second defendant which hired it out to the claimant, Lobster Group. There were three contracts: (a) the hire agreement between the claimant and the second defendant in respect of the printing press; (b) the warranty agreement between the claimant and first defendant for a limited period of time; and (c) the service agreement between the claimant and the first defendant. The claimant claimed in respect of defects in the printing press for which the defendants denied liability given the way the contractual relationships with the claimant were structured.

31 The relevant exclusion clauses in the service and warranty agreements were to limit the liability of the first defendant to replacing or repairing the defective part and to exclude all liability, whether for immediate or consequential loss. The claimants argued that these clauses did not satisfy the requirement of reasonableness under UCTA.

33 The Times (14 August 1996) (CA).
34 [1983] 2 AC 803.
35 [2009] EWHC 1919 (TCC).

In determining this issue, Ramsey J took into account the following factors: (a) both parties were reasonably substantial commercial entities; (b) both parties had previous dealings in the supply of an earlier version of the printing press; (c) the first defendant would not have been liable for the defects, absent the warranty; and (d) the claimant was in the best position to know its likely losses in the event of defects and it had some insurance cover (the relevant consideration being the availability of insurance and not the actual insurance position of the parties). Ramsey J therefore held that the limitation of liability was not unreasonable. While the exclusion of liability for consequential losses was also reasonable, he found the exclusion of liability for immediate loss, direct damage or increased costs or expenses in paying others to remedy the defects if the first defendant failed to repair to be unreasonable. The latter exclusion had the effect of invalidating the exception clause as a whole as the courts do not have the power to sever the unreasonable parts from the reasonable parts. This is a timely reminder not to draft exception clauses too broadly. With regard to the hire agreement between the claimant and the second defendant, the judge held that it was reasonable to exclude liability for loss of profits and consequential loss because it would be the claimant who would know what losses would be incurred and to insure against such risks. However, it would be unreasonable to exclude all liability which arose from the unsatisfactory quality of the printing press. Ramsey J reached this conclusion, clearly influenced by the desire to avoid leaving the claimant without a meaningful means of redress due to the restructuring of the parties' contractual relationships.

32 Moving on to limitation clauses, the rationale for their different treatment from exclusion clauses was discussed in *Ailsa Craig Fishing Co Ltd v Malvern Fishing Co Ltd*; *Malvern Fishing Co Ltd v Ailsa Craig Fishing Co Ltd.*[36] The respondent ("Securicor") contracted to provide security services to the Aberdeen Fishing Vessel Owners' Association Ltd ("Association") who were acting for a number of owners of fishing vessels, including the appellant. The latter's fishing vessel "*Strathallan*" sank while berthed in Aberdeen Harbour at a time when Securicor was bound to provide security cover in the Harbour. Her gallows fouled the vessel moored next to her, the "*George Craig*", on the starboard side and it also sank. Both vessels became total losses. Two actions arose: (a) the appellant claimed damages from the owners of the "*George Craig*" as first defender and from Securicor as second defender; (2) the owners of the "*George Craig*" claimed damages from the appellant, who brought in Securicor as a third party.

33 The sole issue was whether the liability of the respondent had been effectively limited. Lord Wilberforce reiterated that whether a

36 [1983] 1 WLR 964.

clause limiting liability is effective or not is a question of construction of that clause in the context of the contract as a whole. If it is to exclude liability for negligence, it must be most clearly and unambiguously expressed, and in such a contract as this, it must be construed *contra proferentum*. However, his Lordship clarified that one must not strive to create ambiguities by strained construction. The relevant words must be given, if possible, their natural, plain meaning. Clauses of limitation are not regarded by the courts with the same hostility as clauses of exclusion. This is because they must be related to other contractual terms, in particular to the risks to which the defending party may be exposed, the remuneration which he receives, and possibly also the opportunity of the other party to insure.

34 It was clear on the findings that the respondent was negligent and in material breach of contract in not providing continuous security cover for the vessels as stipulated in the contract.

35 Lord Fraser of Tullybelton referred to authorities which laid down very strict principles to be applied when considering the effect of clauses of exclusion or of indemnity – in particular the Privy Council case of *Canada Steamship Lines Ltd v The King*.[37] In his Lordship's opinion, these principles are not applicable in their full rigour when considering the effect of clauses merely limiting liability. Such clauses will of course be read *contra proferentum* and must be clearly expressed, but there is no reason why they should be judged by the specially exacting standards which are applied to exclusion and indemnity clauses. The reason for imposing such standards on the latter clauses was the inherent improbability that the other party to a contract including such a clause intended to release the *proferens* from a liability that would otherwise fall upon him. But there is no such high degree of improbability that he would agree to a limitation of the liability of the *proferens*, especially when the potential losses that might be caused by the negligence of the *proferens* or its servants are so great in proportion to the sums that can reasonably be charged for the services contracted for. It was enough in the present case that the clause must be clear and unambiguous. In Lord Fraser's opinion, it was sufficiently clear and unambiguous to effectively limit the liability of Securicor for its own negligence. For these reasons the appeal would be dismissed.

36 The House of Lord's approach to clauses of limitation was not followed in *Darlington Futures Ltd v Delco Australia Pty Ltd*.[38] In that case, the High Court of Australia stated the view that the same principle of construction applied to both exclusion and limitation clauses in the following terms:

37 [1952] AC 192 at 208.
38 [1986] HCA 82, (1986) 161 CLR 500 at 510.

> 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 object of the contract, and, where appropriate, construing the clause *contra proferentum* in case of ambiguity. A limitation clause may be so severe in its operation as to make its effect virtually indistinguishable from that of an exclusion clause. And the principle, in the form in which we have expressed it, does no more than express the general approach to the interpretation of contracts and it is of sufficient generality to accommodate the different considerations that may arise in the interpretation of a wide variety of exclusion and limitation clauses in formal commercial contracts between business people where no question of the reasonableness or fairness of the clause arises.

37 Although the English courts tend to be more lenient towards limitation clauses, these clauses must still pass the reasonableness test. *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd*[39] ("*George Mitchell*") is a case in point. The plaintiff orally ordered 30lbs of "Finney's Late Dutch Special" cabbage seed from the defendant seed merchants. The plaintiff had dealt with the defendant for many years and knew that the sale was subject to the relevant conditions of sale. The defendant delivered the seeds to the plaintiff with an invoice containing conditions of sale which, *inter alia,* restricted liability in the event that the seeds sold proved defective in varietal purity, to their replacement or to refund of the price paid. The conditions also provided for the total exclusion of all liability for any loss or damage arising from the use of any seeds supplied save their replacement or price refund. As it turned out, the seed supplied was not late cabbage seed and was unmerchantable and commercially useless when it germinated and grew. The price of the seed was £201.60. The loss to the plaintiff was over £61,000. The defendant relied on the conditions of sale which the plaintiff argued were unreasonable and void under s 55(3) of the Sale of Goods Act 1979.[40] Parker J was satisfied that it was possible for the defendant to insure against the risk and the cost of so doing would not materially raise the seed price on the market. The protection against this very rare case was not reasonably required. It was also possible for the defendant to test the seeds before putting them on the market. Parker J therefore held that "it would make commercial nonsense of the contract to suggest that either party intended it to operate where what had been delivered was wholly different in kind from what had been ordered and

39 [1983] 2 AC 803.

40 Sale of Goods Act 1979 (c 54) (UK). The Unfair Contract Terms Act 1977 (c 50) (UK) did not apply as the contract was concluded before it came into force on 1 February 1978. The test of reasonableness for present purposes is essentially the same under the Unfair Contract Terms Act 1977 and the Sale of Goods Act 1979.

agreed to be supplied" and he gave judgment for the plaintiff for £61,513 and interest. The defendant appealed. Lord Denning MR pointed out that the buyer had no opportunity at all of knowing that the seed was not cabbage seed whereas the defendant could have known that it was the wrong seed altogether. The buyer was not covered by insurance, nor could it insure. The Court of Appeal therefore upheld Parker J's judgment. The House of Lords similarly held that the clause was not reasonable on three grounds: (a) the defendant commonly made *ex gratia* payments in similar cases of defective seeds. This suggested that the defendant itself did not consider the clause to be reasonable; (b) it was unreasonable to allow the defendant to rely on the clause when the breach was due to its own negligence; and (c) the defendant could have insured against liability for defective seeds and this would not have significantly increased the contract price.

38 These decisions can be supported on the basis that the actual loss suffered by the plaintiff (£61,513) was far in excess of the contract price (£201.60) and it would not be fair or reasonable in the circumstances of the case to allow the defendant seed merchants to limit their liability to the contract price.

39 In relation to the task of an appellate court in reviewing on appeal a statutory provision requiring determination of the question whether a term in a contract is fair and reasonable, Lord Bridge of Harwich stated the position in the following terms:[41]

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

It is submitted that this makes it harder to overturn a first instance decision as to what is reasonable in all the circumstances of a particular case.

40 With regard to the effect of relaxing an exception clause, *George Mitchell* may be distinguished from *Schenkers Ltd v Overland Shoes Ltd*[42] ("*Schenkers*"). Schenkers entered into a contract to transport shoes that Overland were importing from China. The standard form contract contained a no set-off clause against any payment due from Overland to Schenkers. When Overland sought to set off the VAT owed by Schenkers

41 *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] 2 AC 803 at 815G.
42 [1998] 1 Lloyd's Rep 498.

against certain freight charges, the latter relied upon the clause. Overland argued that the clause was an exception clause and was unreasonable. It had not been applied in practice over a long period of trading. The Court of Appeal held that the clause was reasonable, having regard to the following factors: (a) the clause was well known in the shipping industry and in common use by trade associations around the world; (b) it was recognised as being well balanced, fair and reasonable; (c) there was no significant inequality of bargaining power; and (d) the "give and take" practised by the parties where the clause was not rigorously enforced did not prevent Schenkers from relying on the clause and claiming the full freight charges from Overland.

41 The relaxation of an exception clause may in practice be commercially prudent, but may prove fatal to the *proferens* as in *George Mitchell* but not in *Schenkers.* In the former case, seed merchants rarely, if ever, invoked the clause. The seed trade did not stick to the strict letter of the clause and almost invariably when a customer justifiably complained, the trade paid something more than a refund. In *Schenkers*, the clause in question was in common use in the industry and recognised to be well balanced, fair and reasonable. Thus, the court in each case took into consideration the relevant trade customs in determining the reasonableness of the exception clause.

42 Another case giving effect to the commercial arrangements between the parties is *SAM Business Systems Ltd v Hedley & Co*[43] where the court upheld the exclusion clause for consequential losses as being reasonable on the basis that the supplier would remain liable for direct losses although this would be restricted to the price of the software. Such an arrangement was usual and well known in the computer software industry where defects were common. As such, it was considered appropriate and reasonable to restrict liability for direct losses and to exclude liability for consequential losses. It is submitted that if total liability were to be factored into the price of software, the cost to the consumer would be prohibitive.

V. English and Scottish law reform

43 The English Law Commission, Consultation Paper No 166 and the Scottish Law Commission Discussion Paper No 119 on *Unfair Terms in Contracts, A Joint Consultation Paper*[44] proposed that detailed

43 [2003] 1 All ER (Comm) 465.

44 The terms of reference are to replace the Unfair Contract Terms Act 1977 (c 50) (UK) and the Unfair Terms in Consumer Contract Regulations 1999 with a unified regime consistent with the Council Directive 93/13/EEC on Unfair Terms in Consumer Contracts. "UCTA is a complex piece of legislation. … it is hard to understand fully without careful reading" at para 1.6. "The 1977 Act is written in a

(*cont'd on the next page*)

guidelines on the application of the fair and reasonable test should be provided in the new legislation replacing UCTA and the regulations. The Law Commissions considered that a list of factors relevant to the application of the fair and reasonable test would give the clearest possible guidance on how this test should be applied. This list should build on the existing guidelines in Schedule 2 to UCTA.

A. Factors to be taken into account in assessing fairness

44 These should include the following:

(a) Whether a clause is fair and reasonable is to be determined by reference to the time when the contract was made and taking into account the substance and effect of the term and all the circumstances existing when the contract was made.

(b) Whether it is fair and reasonable to allow reliance on a notice is to be determined by reference to the time when the liability arose and taking into account the substance and effect of the notice and all the circumstances existing when the liability arose.

(c) In determining for the purposes of s 6 or s 7 of UCTA whether a contract term satisfies the requirement of reasonableness, regard shall be had in particular to the matters specified in Schedule 2.

(d) Where a term seeks to restrict liability to a specified sum of money and the issue is whether the term or notice satisfies the requirement of reasonableness, regard shall be had in particular to available resources to meet liability should it arise and how far it was open to cover by insurance.

(e) Whether the contract is transparent in the sense of being expressed in plain language, reasonably easy to follow and to read and accessible to the other party; the possibility and likelihood of insurance (as in s 11(4) of UCTA). The extent to which an exclusion clause is transparent is already a factor to be taken into account under UCTA. Schedule 2 guideline (c) refers to whether the customer knew or ought reasonably to have known of the existence and extent of the term (having regard, *inter alia*, to any custom of the trade and any previous course of dealing between the parties).

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particularly dense style, which even specialist lawyers find difficult to follow" – Scottish Law Commission (LC No 298; SLC No 199).

(f) Other ways in which the consumer might protect his position (*eg*, getting advice on the transaction from an expert).

(1) Circumstances existing when the contract was made

45 The Law Commissions suggested that there should be a reference to the fairness of the term in light of the circumstances existing when the contract was made. These would include the following:

(a) the knowledge and understanding of the party adversely affected by the term;

(b) the strength of the bargaining positions of the parties;

(c) the nature of the goods or services for which the contract was concluded;

(d) other terms of the contract;

(e) terms of any other contract on which the contract is dependent.

(2) Knowledge and understanding of the party adversely affected by the term

46 The Law Commissions suggested the following:

(i) that it should be considered in the light of previous dealings, if any;

(ii) whether the party adversely affected knew of the term;

(iii) whether he understood the meaning and implications of the term;

(iv) what other persons, in a similar position, would normally expect in the case of a similar transaction, the complexity of the transaction;

(v) information given before or when the contract was made;

(vi) whether the contract was transparent;

(vii) the way the contract was explained;

(viii) whether he had a reasonable opportunity to absorb the information before making the contract;

(ix) whether he took, or could reasonably be expected to take, professional advice and

(x) whether he had a realistic opportunity to cancel the contract without charge.

47 Items (v) to (x) are particularly relevant where the transaction is complex.

(3) Strength of the bargaining positions of the parties

48 The Law Commissions regarded the following matters to be relevant:

(i) whether the transaction was an unusual one for either of the parties;

(ii) whether the party adversely affected was offered a choice over the term;

(iii) whether he had an opportunity to seek a more favourable term;

(iv) whether he had an opportunity to enter into a similar contract with other persons but without that term;

(v) whether there were alternative means by which his requirements could have been met;

(vi) whether it was reasonable, given his abilities, for him to take up any such opportunities mentioned in (ii) to (v) above.

49 These seek to clarify a much misunderstood phrase.[45]

(4) Schedule 2 Guidelines for the application of the reasonableness test

50 The Law Commissions proposed the following guidelines:

(a) the relative bargaining positions of the parties, taking into account, *inter alia*, alternative means by which the customer's requirements could have been met;

(b) whether the customer received an inducement to agree to the term or had an opportunity of entering into a similar contract with other persons but without having to accept a similar term;

(c) whether the customer knew or ought reasonably to have known of the existence and extent of the term having regard to, *inter alia*, any custom of the trade and any previous course of dealing between them;

45 Case law suggests that the phrase is used in two senses: (a) lack of sophistication: *Lloyd's Bank v Bundy* [1975] QB 326 at 339 (CA); and (b) lack of market power: *St Albans City and District Council v International Computers Ltd* [1995] FSR 686 (QBD).

(d) where the term excludes or restricts liability if some condition is not complied with, whether it was reasonable at the time of the contract to expect that compliance with that condition would be practicable, *eg*, a term of a loan agreement which obliges the customer to take the loan in circumstances where the other party is under an obligation to make the loan only with the approval of one of its managers;

(e) whether the goods were manufactured, processed or adapted to the special order of the customer.

VI. Other common law jurisdictions

51 There is no legislative equivalent to UCTA in New Zealand, the United States or Canada although there is consumer protection/fair trading legislation which is relevant to the issue of unfair terms in general. In New Zealand, there is no general protection for unfair terms but there is legislation targeting specific contracts such as hire-purchase, insurance, door-to-door sales and unsolicited goods. Businesses are also given protection by certain legislation. In the US, there is control over an unconscionable contract or clause under §2-302 of the Uniform Commercial Code. The parties may present evidence as to the commercial setting, purpose and effect of the contract or any clause to aid the court in assessing the question of unconscionability. The court may refuse to enforce the contract, or the remainder of the contract without the unconscionable clause, or it may limit the application of any such clause so as to avoid any unconscionable result. It is submitted that the issue of unconscionability goes beyond the requirement of reasonableness, although the distinction has been somewhat blurred in the Canadian cases discussed below. In Canada, consumer protection legislation provides protection against unfair terms in a number of provinces.

A. Australia

52 For the purpose of this article, Australia's single, national consumer law known as the Trade Practices Amendment (Australian Consumer Law) Act (No 1) 2010, passed in March 2010, is significant as it sheds light on the meaning of an unfair contract term. The Australian Act goes further than UCTA in regulating all unfair terms and not merely exception clauses. From 1 July 2010, unfair terms in standard form consumer contracts will be void. The contract will continue to be valid insofar as it can operate without the unfair term. Whether a term is unfair will be decided by the court having regard to the factors outlined in the law as well as any other matter that the court thinks

relevant such as the extent to which the term is transparent[46] and the contract as a whole.

53 It is submitted that although the Act applies only to consumer contracts, the criteria that is used may be extended to commercial contracts in the same way that Schedule 2 of UCTA has been applied to B2B contracts. Under s 3 of the Australian Act, a term is unfair if: (1) it would cause a significant imbalance in the parties' rights and obligations arising under the contract; (2) it is not reasonably necessary to protect the legitimate interests of the party who would be advantaged by the term; and (3) it would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on. All three limbs must be proven, on a balance of probabilities, before a court can decide that a term is unfair. Under (2) above, the advantaged party must show why it is necessary to include the term, *eg*, business costs and business structure, the need for the mitigation of risks or particular industry practices. Criteria (3) above includes delay and distress suffered by the consumer as a result of the unfair term. The fairness of the term must be considered in light of the contract as a whole and not in isolation. Thus a term which has been decided to be fair in one case, may not be fair in another case and *vice versa.* The Act provides some mechanism for determining whether an exception clause is reasonable. It contains a non-exhaustive list of unfair terms for guidance only and these are not to be treated as conclusive in all cases. Included in this list are terms that permit one party (but not the other party) to avoid or limit performance of the contract. Such clauses have the potential to cause a significant imbalance in the parties' rights and obligations arising under the contract. Terms may be less likely to be considered unfair where a consumer understands the effect of the term or is given reasonable notice of its effect, *eg*, reimbursements available to the consumer when such terms are relied upon by the business. There are many instances where limitations of liability are expressly permitted by commonwealth, state or territory legislation for public policy reasons, *eg*, for recreational services.

B. Canada

54 It is significant for present purposes that the Canadian courts introduced additional requirements, including reasonableness, when assessing whether or not an exclusion clause should be effective in a particular case. The Supreme Court of Canada took two approaches in *Syncrude Canada Ltd v Hunter Engineering Co*[47] ("*Hunter Engineering*"). It asked whether the result of enforcing an exception clause would be

46 If expressed in reasonably plain language, legible, presented clearly and readily available to any party affected by the term.

47 [1989] 1 SCR 426, 57 DLR (4th) 321 (SCC).

unconscionable (according to Dickson CJC) or unfair, unreasonable or otherwise contrary to public policy (*per* Wilson J). Dickson CJC was inclined to adopt the approach of the House of Lords in *Photo Production Ltd v Securicor Transport Ltd*[48] by upholding the bargain struck between the parties and holding them to the terms of their agreement, unless the agreement was unconscionable. He disagreed with Wilson J's approach which required the court to assess the reasonableness of enforcing the exception clause after it had already construed the meaning of the clause based on the ordinary principles of contract interpretation. However, whichever basis was used, Wilson J believed the result would be the same since the question essentially was this: in the circumstances that had happened, should the court allow the party in breach to hold the other party to the clause? The difference in approach is essentially this: Dickson CJC's approach is to avoid an unconscionable result. Wilson J would ask whether enforcing the clause would be unfair, unreasonable or otherwise contrary to public policy.

55 The approaches in *Hunter Engineering* were interpreted by the Ontario Court of Appeal in *Shelanu Inc v Print Three Franchising Corp*[49] as having little distinction. Both approaches were applied by Dillon J in *Tercon Contractors Ltd v British Columbia (Minister of Transportation and Highways)*[50] and by the Supreme Court of Canada in *Guarantee Co of North America v Gordon Capital Corp*.[51] The two approaches in *Hunter Engineering* were considered in *Romfo v 1216393 Ontario Inc*[52] where Myers J concluded that it was open to a court to apply either of the approaches.

56 In *Tercon Contractors Ltd v British Columbia (Minister of Transportation and Highways)*[53] ("*Tercon*"), the appellants ("Ministry") issued a Request for Expression of Interest ("RFP") for the construction of a 25km highway and received submissions from B Ltd and the respondents, Tercon Contractors Ltd. The Ministry rejected a bid from Tercon and accepted a bid from another joint venture comprising a qualified bidder and one which was not. The trial judge found that the Ministry had tried to hide the true identity of the contracting party by issuing contract B[54] only in the name of the qualified bidder, B Ltd. The trial judge held that Tercon's bid was compliant and the other contractor's bid was non-compliant and thus the Ministry breached

48 [1980] AC 827.
49 (2003) 64 OR (3d) 533.
50 2006 BCSC 499, 53 BCLR (4th) 138 (BC Supreme Court).
51 [1999] 3 SCR 423, 178 DLR (4th) 1.
52 (2008) 80 BCLR (4th) 90 (BC Supreme Court).
53 (2008) 73 BCLR (4th) 201 (BC Court of Appeal), (2010) SCC 4.
54 Contract A is the process contract in the call for tenders and Contract B is the ultimate construction contract.

contract A with Tercon. She awarded damages to Tercon in the amount of $3,293,998.00.

57 The appeal raised two issues: (a) Was the successful bid non-compliant? (b) Was the claim barred by an exclusion clause in contract A?

58 The RFP contained an exclusion clause in para 2.10 in the following terms:

> Except as expressly and specifically permitted in these Instructions to Proponents, no Proponent shall have any claim for any compensation of any kind whatsoever, as a result of participating in this RFP, and by submitting a proposal each proponent shall be deemed to have agreed that it has no claim.

59 The trial judge, Abella J, analysed relevant authority on the nature of the breach and concluded that the Ministry had committed a fundamental breach in accepting and approving a non-compliant bid when the proponent was ineligible to bid in the first place. The judge then considered whether the breach was covered by the exclusion clause, as a matter of interpretation. She found that the clause was ambiguous and that it was "inconceivable" that the parties could have intended to exclude liability for such a fundamental breach as occurred in this case.

60 The judge went on to decide whether, assuming the clause included fundamental breach, the court should enforce it. On the basis that enforcement would lead to an unconscionable result, and that the Ministry had acted improperly, the judge would not give effect to the clause. The Ministry had acted improperly by trying to disguise the true state of affairs by, amongst other ways, awarding the contract in B Ltd's name alone.

61 Donald JA, delivering the judgment of the Court of Appeal, agreed with the trial judge's analysis of the law but differed from her in only one crucial respect and that was the interpretation of the clause. He found the words of the exclusion clause so clear and unambiguous that it showed that the parties intended it to cover all defaults, including fundamental breaches. A sophisticated contractor like Tercon who had already recovered damages from the Ministry on a bidding default in another case, would have had in contemplation at the time of the RFP all potential breaches, including the acceptance of a non-compliant bid. The broad words of the clause covered the full range and the court saw no room for exempting fundamental breaches from the scope of the clause. Thus, if the parties clearly intended exclusion for fundamental breaches, then it was difficult to say it would be unconscionable, unfair or unreasonable to enforce the bargain between sophisticated parties who were on a roughly equal footing.

62 Although the trial judge did not engage in a public policy analysis, Tercon sought to support the judgment on the basis that to the extent the clause excused acceptance of non-compliant bids, the public interest in an orderly and fair scheme for tendering in the construction industry was thwarted. While the Court of Appeal saw this as a valid point, it did not see the answer in judicial intervention in commercial dealings like this but in the industry's response to all-encompassing exclusion clauses. If the major contractors refused to bid because of the damage to the tendering process, the Ministry's approach might change.

63 In summary, the Court of Appeal found the exclusion clause to be clear and unambiguous and it effectively barred Tercon's claim. This decision was overturned by the Supreme Court of Canada by a four-to-three majority, which restored the trial judge's decision. While the Supreme Court unanimously agreed on the approach to be taken towards exclusion clauses, it was divided on the applicability of the clause to the facts of the case. The Supreme Court unanimously agreed on the appropriate framework of analysis and held that the doctrine of fundamental breach should be "laid to rest". In its place, three issues arose for consideration: (a) whether as a matter of interpretation, the exclusion clause applied to the circumstances established in evidence. If the clause applied, (b) whether the exclusion clause was unconscionable and thus invalid at the time the contract was made. If the clause was valid and applicable, (c) whether the court should nevertheless refuse to enforce the exclusion clause because of an overriding public policy. Considerations of public policy (*eg*, egregious fraud or serious criminality) must be such that they outweighed the public policy of freedom to contract and prevent the *proferens* from relying on the exclusion clause. By considering a bid from an ineligible bidder, the Ministry not only breached the contract but did so in a manner that was an affront to the integrity and business efficacy of the tendering process. The majority of the Supreme Court therefore concluded that the Ministry could not rely on the exclusion clause to preclude Tercon's remedy in damages for the breach. On the other hand, the dissenting view was that while the Ministry was in breach of contract, its conduct fell within the terms of the exclusion clause which was clear and unambiguous. The misconduct did not rise to the level where public policy would justify the court in depriving the Ministry of the protection of the exclusion clause freely agreed to by Tercon in the contract. Tercon, a sophisticated and experienced contractor, chose to bid on the project, including the risk posed by the exclusion clause and there was no relevant imbalance of bargaining power to speak of. The clause was not unconscionable and it effectively barred Tercon's claim.

64 It is evident that both approaches in *Hunter Engineering* were applied in *Tercon*. It is submitted that the different views expressed in *Tercon* are explicable on the basis of whether or not the principle of

freedom of contract should prevail over considerations of public interest in the integrity of the tendering process. The judges who were willing to uphold the exclusion clause took the view that in the absence of inequality of bargaining power between the parties, the principle of freedom of contract should prevail. Moreover, the misconduct of the Ministry was not such as to warrant the striking down of the exclusion clause on policy grounds. On the other hand, the majority of the Supreme Court thought that the public interest in the proper conduct of the Ministry and the integrity of the tendering procedure should override the principle of freedom of contract. In these circumstances, to enforce the exclusion clause would lead to an unconscionable result. It is probably due to the fact that the Ministry is a public body that considerations of public interest were significant here. This is less likely to be so in the case of commercial contracts where the parties are of equal bargaining power and there is more reason not to interfere with the bargain that the parties have struck.

VII. Conclusion

65 The question of reasonableness depends on the facts of each particular case. The burden of proving reasonableness, on a balance of probabilities, lies with the *proferens*. The more unreasonable the clause appears to be, the greater is the burden on the *proferens*. The time for determining reasonableness is the time the contract was made and not the time when it was breached, taking into account the substance and effect of the term and all the circumstances existing when the contract was made. The circumstances would include those suggested by the English and Scottish Law Commissions in Section V para A(2), items (a) to (e) above. Item (a) is further elaborated on in (i) to (x) above. Whether a notice excluding liability is fair should be determined by reference to the time when the liability arose, taking into account the substance and effect of the notice and all the circumstances existing when the liability arose. The question of reasonableness must be assessed having regard to the relevant clause viewed as a whole and not against any particular part of the clause in isolation. Whether the customer knew or ought to have known of the existence and extent of the term having regard, *inter alia,* to any custom of the trade and any previous course of dealing between the parties would be relevant. The reality of the consent of the customer to the clause may also be taken into account. The fact of agreeing to the exception clause does not preclude a party from challenging the validity of the clause. Neither does the fact that the parties are commercial parties dealing in the course of business *per se* satisfy the reasonableness requirement. A provision commonly used in an industry may be reasonable by reason of its common usage but this is not conclusive.

66 From the foregoing discussion of the question of reasonableness, this article suggests the following criteria that may be applicable in appropriate cases.

A. Bargaining power

67 Courts have to balance the public policy of holding parties to their bargain against the need to protect the disadvantaged or weaker party in cases of inequality of bargaining power. The English and Scottish Law Commissions have identified certain factors as being relevant to the strength of the bargaining positions of the parties relative to each other. Experienced business people are fully aware of standard terms and conditions of business and will usually agree on what they think makes good business sense. The more equal the bargaining power, the more likely that the clause will be held to be reasonable. Were both parties substantial commercial entities or was one party a small business or a consumer? To what degree was the exception clause negotiated on an equal footing by both parties? Was the customer obliged to use the services of the supplier and how far was it practicable and convenient to go elsewhere? Did the customer receive an inducement to contract out or, in accepting the clause, did he have an opportunity of entering into a similar contract with other persons, but without having to accept a similar term? Did the customer contract out of convenience and for the price (small fee to minimise costs) or could he have contracted without the exception clause but with a price increase in lieu? Was it a calculated decision?

B. Availability of insurance

68 It is the availability and not the actual insurance position of the parties that matters. The availability of insurance to the *proferens* is relevant but it is by no means a decisive factor. Who is better able to bear the loss? Which party can insure more cheaply? Are losses recouped from insurance? Claimants may be in the best position to know what losses would be incurred in the event of a breach and to insure against such risks. It may not be possible for the *proferens* to assess the type and extent of losses. It may therefore be more economical for business customers to arrange their own insurance. If the *proferens* took out insurance, the cost would be passed on to customers. Sorting out the *proferens*' liability may be complex, uncertain and expensive. Therefore limitations or exclusions may be considered reasonable if the losses are ultimately borne by insurance.

C. Resources available to meet liability

69 The resources expected to be available to the *proferens* for the purpose of meeting the liability should it arise would be relevant. If the *proferens*, a commercial party, is insured for a sum more than the cost of liability, it ought to be made liable for the full loss.

D. Independent advice

70 How far was it practicable to take independent advice, taking into account the costs and time that may be incurred in obtaining such advice? Were there any other ways in which claimants might protect their position?

E. Transparency

71 Whether the contract is transparent in the sense of being expressed in plain language, reasonably easy to follow and to read, whether it is accessible to the other party, whether the other party understands the effect of the term or is given reasonable notice of its effect are all relevant considerations. These are among the factors proposed by the English and Scottish Law Commissions. Transparency is also required in the new Australian Act.

F. Schedule 2 matters

72 The five guidelines as to reasonableness set out in Schedule 2 are relevant to the question of reasonableness in both consumer and commercial contracts.

G. Trade customs/industry practice

73 The requirement of reasonableness may be satisfied if the exception clause is in common use and well known in a particular industry around the world and considered to be fair and reasonable. For example, in the computer software industry, defects in software are common and difficult to avoid. It may therefore be considered reasonable to limit liability for direct losses and exclude liability for consequential losses which may run into significant amounts. However, the exception clause may not be reasonable if there is clear recognition in the industry that reliance on it would be unfair or unreasonable and the *proferens* could insure against the risk without materially increasing the price. Where there has been "give and take" without rigorously enforcing the clause, the *proferens* may seek to rely on the clause. In cases of limitation rather than exclusion of liability, the size of the limit

compared with other limits in widely used standard terms may also be relevant.

H. Practical consequences of the decision on the question of reasonableness

74 Who is better able to bear the loss? On whom would the loss eventually fall? Would claimants be left without a meaningful means of redress? Would the exception clause cause a significant imbalance in the parties' rights and obligations arising under the contract? Terms which permit one party but not the other to avoid or limit performance have the potential of causing a significant imbalance in the rights and obligations arising under the contract. Is it reasonably necessary to protect the legitimate interests of the party who would be advantaged by the term? Would it cause detriment to a party if the clause were to be applied or relied on? Would enforcing the clause lead to a result that is unconscionable or unfair, unreasonable or otherwise contrary to public policy?

75 Notwithstanding the above guidelines, much turns on the particular facts of the case and on the discretion of the judge. For instance, English appellate judges have refrained from interfering with the findings of fact of the trial judge unless "satisfied that the judge proceeded upon some erroneous principle or was plainly and obviously wrong".

76 In conclusion, the ability to challenge unreasonable exception clauses gives better protection to the weaker contracting party against detrimental contractual circumstances. Businesses could also reduce the threat of litigation by proactively revising unreasonable terms. This will eliminate possible business costs and increase consumer confidence which is always of benefit to the market.