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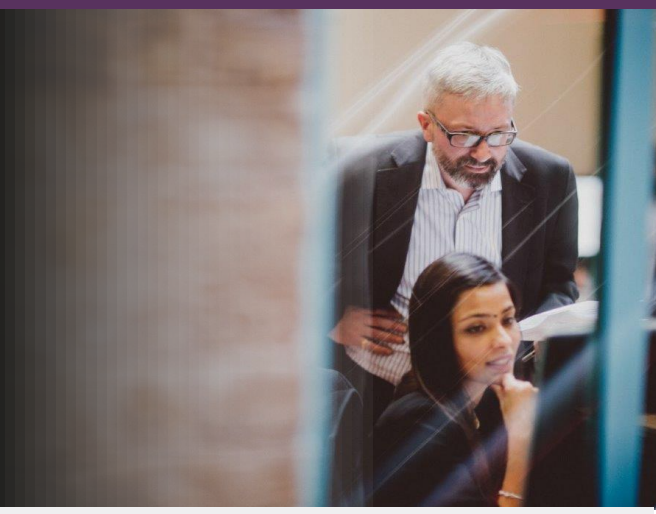
Excluding liability in commercial contracts



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Most commercial contracts use liability clauses to manage risks in the event of default, either by excluding liability altogether or setting a limit on liability.

Commercial parties must ensure that any exclusions or limitations comply with the “reasonableness test” found in the Unfair Contract Terms Act 1977 (UCTA), as well as common law.

The reasonableness test

To be valid, a contract term excluding or limiting liability must be “fair and reasonable” under Section 11 of UCTA.

The guidelines for determining what is "fair and reasonable" are set out in schedule 2 of UCTA, which provides that a contract term is more likely to be deemed reasonable:

- if both parties are commercial parties of roughly equal bargaining power;
- if the customer received an inducement to agree to the term, or in accepting it, had the opportunity of entering into a similar contract with another party without a similar term;
- if the customer knew or ought to have known of the existence and the extent of the term, based on any previous course of dealing or custom of the trade;
- where the exclusion is based on a condition not being complied with, if it is reasonable to expect that compliance with that condition would be practicable;
- if goods have been made or adapted to the individual needs of the customer.

Guidance points for drafting an exclusion clause

Ensure your clause satisfies the reasonableness test.

Under common law, a clause purporting to limit or exclude liability must be included in the contract for it to be valid and it must have been reasonably brought to the other party’s attention. A particularly onerous or unclear exclusion clause should be made visible as opposed to hidden away within terms and conditions.

The words used in the clause must be clear and precise so that its scope can be understood by the other party. An ambiguous clause is likely to fail the reasonableness test as the court cannot tell from the contract what the parties’ intentions were in relation to the risk. Separate and precise clauses should be used, as blanket clauses are less likely to be found as reasonable.

Make sure the liability is excludable in the first place. The following areas of liability cannot be excluded;

- liability for death or personal injury resulting from negligence,
- liability for fraud,
- liability for defective goods under the Consumer Protection Act,
- liability for pre-contract misrepresentation; and
- liability for breach of contract - unless it is found to be reasonable, for example, under a force majeure clause.

The importance of meeting the reasonableness test

If the clause does not comply with UCTA or the guidance points above, it is likely that the clause will not be valid and liability for the risk will not be limited.

It has traditionally been the practice of the court that the burden of proof is on the party seeking to rely on the clause and any doubt in relation to a clause seeking to limit or exclude liability will be decided against the party who wishes to rely on it.

Speak to Victoria Holland today to review your commercial contracts and ensure that your liability clause is reasonable and valid.

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