1. Introduction

The current legislative framework relating to exemption clauses, as provided for by the Unfair Contract Terms Act 1977[1] and the Unfair Terms in Consumer Contracts Regulations 1999[2], has been criticised as creating “inconsistency” and “complexity” because of the differences in scope of application, and the use of different concepts and terminology.[3] Against this background, the Law Commissions of England and Wales, and the Scottish Law Commission have set out the draft Unfair Terms Bill which contains provisional proposals for reform to the legislation relating to exemption clauses.[4]

The undertaking of the project comprised of three parts. First, to consider replacing the two existing regimes with a single unified regime; second to consider extending the scope of the legislation to cover certain business-to-business (B2B) contract terms, which presently fall outside the scope of the UCTA but which if occurred in a consumer contract would fall within the UTCCR; and third, to produce draft legislation which would be clearer and more accessible than either the UCTA or the UTCCR.[5]

This paper considers the tangible result of this project; the substantive provisions of the draft Unfair Terms Bill. It is acknowledged that within the confines of a conference paper it is not possible to present a detailed examination of all aspects and provisions of the proposed legislation, and therefore the paper focuses in particular on how the draft Bill proposes to deal with exemption clauses in business-to-business contracts. This examination forms the first part of the paper. Following on from this, an assessment is made of the impact the proposals may have upon terms in business-to-business contracts which may arise specifically in the context of supplying software. In doing this, a hypothetical perspective is adopted, through which recent case decisions in this field are re-examined with a view to considering how particular exemption clauses could have been construed by the courts if the proposed legislation had been in force. From analysing existing case law and applying the proposed legislation to the case facts, a comparative exercise between the scope and application of the current legislation and that of the proposed legislation can be presented. From this conclusions may be drawn as to whether the proposed legislation may prove to be more effective in securing an appropriate balance between the interests of contracting parties.

2. Existing regime for business-to-business contracts

Under the current legislative framework, if a term in a business-to-business contract purports to exclude or restrict the liability of one of the contracting parties, then that term will be subject to the UCTA. The Act applies to certain terms irrespective of whether the clause was negotiated or presented in a “standard form”, unlike the UTCCR, which only apply to terms which have been drafted in advance and have not been “individually negotiated”. [6] The application of the UCTA is...
such that an exemption clause may be rendered completely ineffective,[7] or it may be deemed effective only if it satisfies the “requirement of reasonableness”[8] and guidelines for the application of the reasonableness test are included in the Act.[9] The burden of proving that a term is reasonable falls upon the party seeking to rely on the clause.[10]

3. Proposed regime for business-to-business contracts

A preliminary study of the Bill reveals that Part 1 governs Business Liability for Negligence, with Part 2 and Part 3 governing Consumer Contracts and Private Contracts, respectively. From structuring the proposed legislation through a separation of its provisions determined by the status of the contracting parties it can instantly be seen to be more user-friendly. In the alternative, under the UCTA, provisions are defined on the basis of the type of liability which has arisen: for example, section 3 of the UCTA covers liability arising in contract and under this section there are provisions relating to both consumer and non-consumer contracts. Therefore under the existing regime the starting position for assessing whether liability has arisen is to determine the type of liability which has arisen. This is undoubtedly a more complex method than the approach which may be taken under the proposed Bill with the preliminary task being to determine the status of the contracting party (i.e. a business, a consumer or a private party) and the type of contract entered into. In doing this, the Bill promotes a straightforward approach toward accessing its relevant provisions and this factor demonstrates one way in which the unified regime has succeeded in facilitating a simplified approach to controlling unfair terms.

As the focus of this paper is to consider the proposals as they impact upon business-to-business contracts, the scope and application of the legislation in respect of business liability will be examined in detail. Business liability is defined under the draft Bill as:

“… liability for breach of an obligation or duty that arises-
(a) from anything that was done or should have been done for the purposes related to a business, or
(b) from the occupation of premises used for purposes related to the business of the occupier”. [11]

It is clearly stipulated that “anything done by an employee of the business which is within the scope of his employment” will fall to be considered within the definition of “anything done for purposes related to a business”. [12]

Through defining the scope of the proposed legislation, it is provided that in business-to-business contracts, controls should apply to terms that have been drafted in advance and which have not been individually negotiated.[13] If a term has been ‘individually negotiated’, it would not fall within the scope of the Bill, demonstrating that a wider range of terms is currently controlled under the UCTA. The exclusion of such terms is justified by the Law Commissions on the basis that “businesses can be expected to understand the implications of individually negotiated terms and to take steps to safeguard their position”. [14]

In the event that a term does fall within the scope and application of the proposed legislation it is noted that the present rules existing under the UCTA are maintained and thus certain exclusions and restrictions are deemed to be of no effect; for example, s. 1(1) of the Bill provides that “business liability for death or personal injury which results from negligence cannot be excluded or restricted by a contract term or notice”. Also directly comparable to the UCTA, exclusions and restrictions relating to liability for negligence arising in the case of other loss and damage, are deemed to be effective only if they pass the relevant ‘test’ as laid down in the legislation. This is discussed in more detail below. In the event that a contract term is held either automatically ineffective or ineffective as a consequence of failing the prescribed test of validity, similar to the treatment of terms which are deemed to be of no effect under the UCTA, the Bill provides that the contract will “continue to bind the parties if the contract is capable of continuing in existence without that term”.

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4. The test of validity

In its entirety, section 1(2) of the draft Bill provides:

“Business liability for other loss or damage which results from negligence cannot be excluded or restricted by a contract term or notice unless (as the case may be) –
(a) the term is fair and reasonable, or
(b) it is fair and reasonable to allow reliance on the notice.”

Therefore, whereas the UCTA subjects certain terms to the test of “reasonableness”, under the proposed Bill certain terms are subject to the “fair and reasonable” test. Given the slight variance in terminology, it must be questioned whether there are any significant differences between the scope and application of the respective tests, and if there are, what impact the proposed changes may have upon contracting parties?

The “fair and reasonable test” provides:

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

In relation to reliance on a notice, rather than a contract term, the same “fair and reasonable” test is to be applied, the only variation being that the assessment is made by reference to the time and circumstances existing not when the contract was made, but when liability arose.

The determining factors of ‘time’, the ‘substance and effect of the term’ and the ‘circumstances existing when the contract was made’, must be considered further.

Reference to time

Under the proposals, the term or notice will be judged by reference to the time the contract was made. This does not demonstrate any significant departure from the earlier wording in the UCTA under which a term is to be judged “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”. Moreover, by confirming this approach towards the timing of the assessment, the validity testing of a clause under the draft Bill can be seen to confirm and therefore promote the planning use of contract law. From basing the assessment of a clause on the time when the contract is made, the parties are in a position to satisfactorily plan the scope of their contractual performances, thereby promoting contractual certainty through more accurately defining their responsibilities and clarifying their contractual obligations. Of course, the alternative approach to assessing a clause on the basis of the time at which the contract is made, would be to assess the clause having regard to the actual breach which has occurred and the consequences which have arisen from it. Such an approach would do little to promote contractual planning and contractual certainty. Indeed, this alternative approach could produce undesirable effects with the possibility that a clause may be found to fail the test of validity on the basis that it “appears unreasonable in the light of unforeseeable events which occurred once the contract had been made”.

Substance and effect of the term

Under the proposed legislation, for a term to be considered to be a fair and reasonable one, the “substance and effect” of the term will be taken into account. In order to determine which factors relate to the substance and effect of a term, clarification is offered in Schedule 1 which
presents a straightforward list of matters identified as being related to the substance and effect of a term. [21] Interestingly, the Bill stipulates that those matters specified “which are relevant must be taken into account” [22] which indicates a clearer and more compelling choice of expression than the existing approach in the UCTA of “matters to which regard is to be had… are any of the following which appear to be relevant”. [23]

Within the Bill, the matters which relate to the substance and effect of a term are:

(a) the balance of the interests of the parties,
(b) the risks to the party adversely affected by the term,
(c) the possibility and likelihood of insurance,
(d) any other way in which his interest might be protected,
(e) the extent to which the term (whether alone or with other terms) differs from what would have been applied in the absence of the term. [24]

Although provisions analogous to those in the UCTA can be identified, for example, the availability of insurance, [25] it can be suggested that the Bill extends the scope of protection more widely, in particular through the all-encompassing paragraph (d). To some extent, the UCTA offers a similar provision to paragraph (d) of the Bill by providing in s.11(2) that the subsection “does not prevent the court or arbitrator from holding, in accordance with any rule of law, that a term which purports to exclude or restrict any relevant liability is not a term of the contract”. [26] However, whereas the approach under the UCTA is based upon a seemingly double-negative premise to broaden the scope of the reasonableness test, i.e. the subsection ‘does not prevent’ a finding that a term is ‘not’ effective; the Bill can be seen to employ a more positive and comprehensive approach under which assessment under the fair and reasonable test may pay heed to ‘any other way’ in which the party’s interest may be protected. It is slight revisions such as these which may prove to be significant in their contribution towards making the draft Bill more accessible to the reader.

**Circumstances existing when the contract was made**

Matters which relate to the circumstances existing when the contract was made include –

(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) the other terms of the contract,
(e) the terms of any other contract on which the contract is dependent. [27]

Paragraphs (a) and (b) are further expanded upon within Schedule 1 and a number of factors are listed as being relevant to determining the matters. Indeed, eleven matters are listed as being relevant to determining the “knowledge and understanding” element, including for example, “any previous course of dealings between the parties” [28] and “whether the contract was transparent”. [29] A further six matters are noted as being relevant to ascertaining the “strength of the bargaining positions of the parties” and these relate to, inter alia, the opportunities available to the party adversely affected by the term to pursue an alternative. [30] It is noted that there are a number of provisions within the Bill comparable to those currently existing within the UCTA. [31] Equally, it is evident that there are elements directly comparable with the UTCCR. [32] although given that that the proposed legislation draws upon the protection afforded by both existing pieces of legislation and is presented as a unified approach to unfair terms, this is to be expected.

What is of particular interest is to evaluate how the scope of protection in a business-to-business context, has been defined under the proposals, both through the ‘fair and reasonable’ test and more broadly. It is anticipated that the proposed legislation will afford greater protection to contracting parties in a business-to-business context, at the most basic level because a wider range of terms will fall within its scope. Indeed, a stated aim of the project undertaken by the Law Commissions was to
consider extending the scope of the legislation to cover certain business-to-business contract terms, which presently fall outside the scope of UCTA, but which if occurred in a consumer contract would fall within UTCCR. The Bill provides that the same ‘fair and reasonable’ test should apply to business-to-business contracts as it would apply to consumer contracts. From applying the proposed legislation in a practical context to case law which has been decided under the existing legislation, the potential impact of the Bill may be illustrated.

**Watford Electronics Ltd v Sanderson CFL Ltd**

This case concerned a business-to-business contract covering the supply of a bespoke software system. The dispute brought into question the effectiveness of entire agreement clauses and the application of the reasonableness test by virtue of the UCTA ss.3(2) and 11. At first instance, Thornton J held that the provisions within Sanderson’s standard terms which purported to exclude pre-contractual misrepresentations were unreasonable in their entirety. He reached this decision by reference to each of the ‘guideline’ matters as set out in the UCTA Schedule 2, and the relevant matter of the availability of insurance. Consequently, it was held that Sanderson could not rely upon the disputed clauses to exclude or restrict its liability: the clauses failed the reasonableness test. However, the appellate court found that Thornton J had reached his decision on the wrong basis and for this reason an appeal hearing was permitted, giving the Court of Appeal the opportunity to consider the issues. The Court held the limitation of liability clause did satisfy the requirement of reasonableness and thus Sanderson’s appeal was successful. While noting a number of considerations relevant to reaching this conclusion, matters such as the experience of the contracting parties, equality of bargaining power, and negotiation of the agreement were identified as being principal reasons for finding in Sanderson’s favour.

The conflicting decisions reached by the courts in **Watford v Sanderson** provide the ideal scenario for conducting the hypothetical test of studying how the proposed bill may have been applied to those facts and determining what outcome may have been reached if the provisions of the Bill were in force. From having considered relevant provisions of the Bill and with knowledge of the case in hand, it is possible to draw upon relevant issues through which the comparative analysis may be conducted. The issues to be considered are: terms not individually negotiated and; the fair and reasonable test.

**Terms not individually negotiated**

As noted above, in business-to-business contracts, the Law Commissions proposed that terms to be governed by the controls should be those terms which have been drafted in advance and which have not been subsequently negotiated. The possible impact of this approach is that certain terms which would be controlled under the UCTA as falling within the definition of a “written standard term of business” may not be controlled under the proposed legislation. In **Watford v Sanderson**, an issue to be considered was whether the terms came within the scope of the UCTA to be determined by reference to the definition of “written standard terms of business”. This was called into question because the contractual documentation between the parties contained the standard terms with addenda to which, were subject to addenda. Sanderson submitted that the effect of the addenda, which had been negotiated between the parties, was that the terms were no longer to be treated as standard written terms and consequently the UCTA did not apply. However, the court found that the terms were “standard written terms of business” for the purposes of the UCTA 1977 and on this basis s.3(2) was to be applied. Although this issue was not appealed against by Sanderson, it can be noted that under the proposed legislation the defendant’s submissions may have been more persuasive. By posing the question of whether the particular term is “in some way standard” rather than whether any of the standard terms have been subject to negotiation, the draft Bill may be applied by Sanderson to advance the argument that the term would fall outside the scope of the proposed controls. As the addenda had been negotiated between the parties and as the addenda related to the disputed term it may be possible to submit that the effect of this was to make the disputed term a negotiated term; or,
rather more specifically, a term not falling within the definition of being “drafted in advance and not
individually negotiated”. This may prove to be a tenuous line of argument but nonetheless, one
which may prove more substantial under the proposed legislation than under the provisions of the
UCTA.

**Fair and Reasonable test**

In the event that a disputed term does fall to be considered within the scope of the proposed
legislation, the relevant test of validity is the “fair and reasonable” test.[43] The disputed clause in
Watford v Sanderson was subject to the test of reasonableness under the UCTA and it has already
been noted that there are a number of comparisons to be drawn between the existing and proposed
legislation in this respect. There are several matters listed within the draft Bill which could be taken
into account in determining whether the term would pass or fail the “fair and reasonable” test.
Chadwick LJ referred to a number of factors which would support Sanderson’s claim that the term
included did satisfy the test prescribed by the UCTA:

“The parties were of equal bargaining strength; the inclusion of the term was, plainly likely to affect
Sanderson’s decision as to the price at which it was prepared to sell its product; Watford must have
been taken to have appreciated that; Watford knew of the term, and must be taken to have
understood what effect it was intended to have; the product was, to some extent modified to meet the
special needs of the customer.”[44]

It is evident that each of these factors could similarly be raised under the proposed legislation. In
broad and simple terms, the ‘risks’ to Watford could be covered under the proposed ‘matters relating
to the substance and effect of the term’, and the ‘matters relating to the circumstances existing when
the contract was made’ listed in the draft Bill, would take account of the relevance of Watford’s
‘knowledge and understanding’. [45]

It must be remembered however, that factors may alternatively, indicate that the disputed term
should fail the test of validity. Indeed, as Chadwick LJ noted:

“Other factors point in the opposite direction. The judge found that, although there were other mail
order packages on the market, [the system] was the only one which appeared to fulfil Watford’s
needs; and further, that Watford could not reasonably have expected to have been able to have
acquired a similar software package, if available, on better terms as to performance and as to the
supplier’s potential liability for non-performance.”[46]

Considering the availability of an alternative under the UCTA is comparable with the direction in the
draft Bill to take into account “any other way in which the party’s interest may be protected”. [47]

From this simple analysis it can be seen that there would be few difficulties in drawing upon relevant
matters within the Bill.

Within the proposed Bill the extensive list of relevant matters to be taken into account when
determining whether a term is to be considered to be fair and reasonable, makes a significant
contribution towards the assessment of disputed terms. The finding in Watford v Sanderson that the
term was a reasonable one to have been included in the contract, is a finding which could equally be
found to fall within the scope of the fair and reasonable test. However, a principal benefit which the
Bill has over the UCTA, is that it sets out in detail, using appropriate and accessible language, an
extensive list of factors which are to be taken into account.

From considering the scope of the fair and reasonable test, and comparing its application in the
Watford v Sanderson case, it would appear that the proposed test of validity deals with terms in
business-to-business contracts similar to their treatment under the UCTA. Indeed, it is apparent that
the court’s finding that the term was a fair and reasonable one, drawing attention to issues such as
the assessment of the risks, the resources available to meet any potential loss, and in particular the
provision of insurance, could lead to a similar finding under the draft Bill. Considerable emphasis
was placed in the case on the relevance of commercial considerations and the fact that both Watford
and Sanderson, as commercial entities had negotiated their agreement and were therefore perceived
as best placed to determine the commercial fairness of their agreement. The draft Bill further
encourages this approach to commercial contracting and it would appear than in doing so, an appropriate balance may have been found between offering protection from unfair terms and preserving freedom of contract.\[48] Through the use of clear expression and language it is hoped that the proposed legislation will prove more accessible and user-friendly to parties when determining the scope of their liabilities particularly in the context of business-to-business computer contracts when the consequences of software failure and therefore the issue of determining liability may be of particular significance.

\[1\] Hereafter referred to as UCTA
\[2\] SI 1999 No 2083, hereafter referred to as UTCCR. See also Unfair Terms in Consumer Contracts (Amendment) Regulations 2001 (SI 2001 No 1186).
\[3\] Unfair Terms in Contracts, Law Commission Consultation Paper No. 166, Scottish Law Commission Discussion Paper No. 119, Executive Summary at S.8
\[4\] Ibid at Appendix B
\[5\] Ibid, Executive Summary at S.9 – S.12
\[6\] See Ibid, Executive Summary at p. xiii, for a list of the principal differences between UCTA and the UTCCR.
\[7\] See for example, s.2 (1) which covers attempts to exclude or restrict liability for negligently caused death or personal injury.
\[8\] For example, s.2(2) which covers attempts to exclude or restrict liability for negligently caused loss or damage not covered by s.2(1). The reasonableness test is set out in s. 11
\[9\] Schedule 2
\[10\] s. 11(5)
\[11\] Section 1(3)
\[12\] Section 1(4)
\[14\] Ibid, Executive Summary page xvii para (3)
\[15\] Draft Unfair Terms Bill s. 12
\[16\] Draft Unfair Terms Bill s. 9(1)
\[17\] Draft Unfair Terms Bill s. 9(2)
\[18\] Unfair Contract Terms Act 1977 s. 11(1)
\[20\] Draft Unfair Terms Bill s. 9(1)(b)
\[21\] Schedule 1 s. 1
\[22\] S.9(3)
\[23\] Unfair Contract Terms Act 1977, Schedule 2
\[24\] Draft Unfair Terms Bill Schedule 1 s. 1
\[25\] Unfair Contract Terms Act 1977, s.11(4) provides: “…whether the term or notice satisfies the requirement of reasonableness, regard shall be had… to… (b) how far it was open to [the party] to cover himself by insurance”.
\[26\] s. 11(2)
\[27\] Draft Unfair Terms Bill Schedule 1 s. 2
\[28\] Schedule 1, s.3(1)(a)
\[29\] Schedule 1, s.3(1)(g)
\[30\] Schedule 1, s.4
\[31\] For example, a reference to ‘previous course of dealings’ is made in UCTA, Sch. 2 para (c), and within the Bill at Sch. 1, s.3(1)(a); reference is made to ‘alternative means by which the customer’s requirements could be met’ within UCTA, at Sch 2 para (a) and within the draft Bill Sch. 1 s.4 (e).
\[32\] For example, the Bill makes reference to ‘whether the party had a reasonable opportunity to absorb any information given’ at Sch. 1 s.3(1)(i): the UTCCR notes that a term may be regarded as unfair if it 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’, Sch. 2, para 1(i).
\[33\] Executive Summary s.10
\[34\] This was provisionally proposed within the Consultation Paper at para. 5.75
\[35\] [2001] 1 All ER (Comm) 696
\[36\] [2001] 1 All ER (Comm) 696 at para 20
\[37\] [2001] 1 All ER (Comm) 696 at para 24
\[38\] [2001] 1 All ER (Comm) 696 at para 54
\[39\] See in particular para 55: “Where experienced businessmen representing substantial companies of equal bargaining power negotiate an agreement, they may be taken to have had regard to the matters known to them. They should, in my view, be taken to be the best judge of the commercial fairness of the agreement which they have made; including the fairness of each of the terms in that agreement…”

[43] Draft Unfair Terms Bill, s. 9(2)

[44] [2001] 1 All ER (Comm) 696 para 52

[45] Draft Unfair Terms Bill, Sch. 1 ss. 2 and 3

[46] [2001] 1 All ER (Comm) 696 para 52

[47] Draft Unfair Terms Bill, Sch. 1 s. 1(d)