

Freedom of Contract vs. Exemption Clauses: A need for Predictability

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Background

The notion of freedom of contract is a fundamental one that gives parties right to incorporate any term they desire. As a result, contracts consist of terms to limit or exclude liability of one party to the contract. Such a party who gained by the inclusion of exemption clause (EC) has been generally the stronger party to the contract and it was even worse in standard form contracts. A large number of cases in this area of law resulted in the formulation of certain principles in dealing with them. Nevertheless it is hard to see some uniformity in the cases decided. Parliament intervened to regulate the EC and thus, the Unfair Contracts Terms Act 1977 of the UK (UCTA–UK) or the similar Unfair Contracts Terms Act No.26 of 1997 of Sri Lanka (UCTA–SL) were enacted and attempted to resolve certain issues by introducing the test of reasonableness into the law. However, have all the uncertainties been settled, and are these statutes striking a balance between the principle of freedom of contract and abuse of it by the acceptance of EC are the questions to be analyzed.

Under the common law the offeror is not under any obligation to draw the attention of the offeree to certain terms in the contract unless such terms are printed in such a manner so as to mislead a reasonably careful businessman, as decided in *Roe v. R.A.Naylor Ltd.* [1971]. However, when a contractual document is accepted by signing by the offeree, he cannot plead that he was ignorant with regard to certain terms unless there was fraud or misrepresentation, and that the knowledge of the contents of a document will be presumed if the contract was signed, as in *L'Estrange v. F.Graucob*[1934]. It can be noticed that more unreasonable or unusual the EC is, the greater the insistence by the court that the EC be drawn to the attention of the other party explicitly by printing in red with a red hand pointing to it. This *red hand rule* was found in *Spurling v. Bradshaw Ltd* [1956] and endorsed later by Lord Denning MR in *Thornton v. Shoe Lane Parking Ltd.* [1971] In the Australian case of *MacRobertson Miller Airline Services v. Commissioner of State Taxation (WA)* [1975]. It was suggested that if an unreasonable clause is included in a printed contract that is not read, and is not likely to be read, there is no acceptance for that clause. *L'Estrange v. Graucob* was followed by the HC of Australia in *Toll (FGCT) Pty Ltd. v. Alphapharm Pty Ltd.* [2004] by emphasizing that if a party to a contract has not read and understood all the terms, but signed is nevertheless committed to the EC contained therein by the act of signature. Still for all, one cannot come to a conclusion that when a signature is put by a party that he is bound by it because it may be interpreted as misrepresentation and it is important to note at this juncture the decision to this effect in the famous laundry case of *Curtis v. Chemical Cleaning and Dying Co* [1951]. After 1977 all the cases were subjected to the test of reasonableness put forwarded by the UCTA–UK. The latest development can be seen in *Trident Turboprop (Dublin) Ltd v. First Flight Couriers Ltd* [2009] in which international supply contracts excluding liability

for misrepresentation and the right to rescind were held not subject to the requirement of reasonableness.

It was said that the courts 'lean against them' when they interpret EC and therefore it was possible for a party to escape from liability only when the EC was clear and precise. This is known as *contra proferentum* and was adopted in many cases including *Hollier v. Rambler Motors (AMC) Ltd.* [1972]. Further, courts have been clear in not accepting EC that were introduced into the contract unilaterally after it was made and this includes exemption clauses found in a receipt. (Cases of *Chapelton v. Barry* [1940], *Olley v. Marlborough Court Ltd.* [1949] and *Thornton v. Shoe Lane Parking Ltd* [1971] are referred.)

In addition to the above common law rules, the doctrine of fundamental breach brought in great amount of uncertainty in the area of EC. This is said to be a rule of construction (and not a rule of law) and emphasize that the EC should not be constructed in a way to protect a party who suggested that such EC to be inserted into the contract if that party has committed a breach that went to the fundamentals of the contract, unless the EC was clear enough to indicate the intention of the parties that they wanted the EC to apply even in such an event. Although this was settled in the cases of *Alexander v. Railway Executive* [1951], *Karsales (Harrow) Ltd v. Wallis* [1956], *Suisse Atlantique Societed' Armement Maritime SA v. N.W.Rotterdamsche Kolen Centrade* [1967] and *Farnworth Finance Facilities Ltd v. Attryde* [1970], a controversy arose after the judgement by HL in *Photo Productions Ltd. v. Securicor Transport Ltd.* [1980] which was after the enactment of the UCTA-UK. The court re-affirmed that the question whether and to what extent an EC is to be applied to a fundamental breach or to any breach of contract is a matter of construction of the contact and gave the judgement in favour of the defendant whose business was providing security services but relied on EC for the negligence of its own employees. How the EC of the defendant in this case passed the requirement of reasonableness is a question despite the fact that both parties are commercial entities. Courts were unsettled on the aspect as to who should prove that there was fundamental breach or not. In *Woolmer v. Delmer Price Ltd* [1955] and *Spurling v. Bradshaw* [1956] it was held that it was on the party who claims EC and contra decision can be found in *Hunt and WinterbothamLtd. v. BRC Parcels Ltd.*[1962] and in some shipping cases.

The UCTA-UK does not apply to all the contracts and is only piecemeal to deal with unfair EC although the title is Unfair Contract Terms. It applies mainly to business liabilities and the Schedule 1 to the Act contains a list of contracts to which certain sections of the Act do not apply. After the enactment of the Act it is no longer possible to exclude or restrict liability in negligence for personal injury or death, s.2 (1). Further, if a party suffer losses or there are damages resulting from a contract that has exemption clause restricting liability, such an exemption clause is void unless it is fair and reasonable, having regard to the circumstances known to the parties when the contract was made, s.2(2). The requirement of reasonableness was a subject for consideration in many recent cases including *Britvic Soft Drinks Ltd v Messer UK Ltd* [2002]. This case is an example for the application of UCTA-UK in the context of consumer protection and the court held that the supplier's exclusion of liability for s.14 of Sale of Goods Act 1979 was unreasonable.

It is to be noted that the UCTA-UK did not eliminate the rules created by the common law. When the liability of EC is on the basis of misrepresentation, the Misrepresentation Act 1967 is applied. Another step in UK relating to controls upon EC is also found in Unfair Terms in Consumer Contracts Regulations 1999 *of the EU*. *Sri Lankan courts did not have the opportunity to analyse any cases relating to EC.*

Methodology

A qualitative method is used in this study.

Findings

While Law of Contracts is left to be decided by common law, the intervention by way of statute in relation to EC is seen in prohibiting or regulating certain types of contracts and not by making rules that can be applied to all types of contracts. The large number of complex situations and different issues within the small area of EC warrants that it is high time to codify rules that can be applied to all contracts whenever parties include EC while having in mind that a balance should be maintained between freedom of contract and very liberal ECs. A balance is also to be maintained in ensuring that the business communities who have no alternative other than making a standard form contract are not discouraged while the consumer interest is retained.