DON'T BE LULLED INTO COMPLACENCY

Exclusion and limitation clauses James Styles advises care in consideration and drafting

Exclusion and limitation clauses aim to protect a party to a contract by excluding or limiting liability against claims for breach of contract or in tort. In this article, we look at two examples of clauses that are commonly encountered in commercial property contracts, and discuss some drafting points.

Entire agreement clauses

Entire agreement clauses are intended to make it more difficult for a party to a contract to bring a claim based on statements made during pre-contract negotiations and investigations. They typically state that the written contract contains the only terms between the parties. They may also acknowledge that the buyer did not enter into the contract in reliance on any representation, warranty or statement made by, or on behalf of, the seller other than any of the seller's written replies to enquiries which could not have been independently verified (a "non-reliance clause").

Such clauses can significantly restrict the scope for buyers to bring claims based on pre-contractual dealings. For example, in *FoodCo UK LLP* v *Henry Boot Developments Ltd* [2010] EWHC 358 (Ch), the tenant claimed to have entered into a lease of a unit in a motorway service station as a result of data in a marketing brochure that overstated the likely number of visitors by around 90%. The landlord argued that the claims for negligent misrepresentation could not succeed because of a non-reliance clause in the lease. The tenant argued that the non-reliance clause did not satisfy the requirement of reasonableness as set out in section 11 of the Unfair Contract Terms Act 1977 (UCTA) and was therefore void.

However, the court found that the clause was reasonable because the parties were of equal bargaining power, the tenant had taken legal advice, the contract was open to negotiation, and the clause allowed the tenant to rely on replies to enquiries.

The only way for the tenant to circumvent the non-reliance clause was to argue that the representations about visitor numbers had been made fraudulently, since it is not possible to exclude or limit liability for fraud. That argument failed because the court found that the landlord genuinely believed the contents of the brochure (which were based on figures provided by a third party consultancy) and had lost more than anyone else in the scheme.

The outcome of this case, and others, such as *Morgan* v *Pooley* [2010] EWHC 2447 (QB), in conjunction with the *caveat emptor* principle, might suggest that non-reliance clauses are a licence for sellers to play fast and loose with pre-contractual statements. However, buyers should be comforted by the knowledge that such clauses do need to be reasonable and, to protect themselves, they should ensure that any statements on which they wish to rely are incorporated into the contract, either directly or in formal replies to enquiries.

Exclusion and limitation of liability clauses

In leases, landlords often seek to exclude or limit liability for failure to provide services, or any interruption in the provision of them. A dispute over faulty air-conditioning in serviced office accommodation led to the case of *Regus (UK) Ltd* v *Epcot Solutions Ltd* [2007] EWHC 938 (Comm). Here, at first instance, the judge construed Regus' exclusion clause as unreasonable under UCTA (and therefore unenforceable) because he thought it denied the licensee any remedy for the licensor's failure to provide the contracted service levels. The clause said, among other things, that the licensee could claim losses only where the licensor's failure was deliberate or negligent. There is a line of case law which supports the view that, even where there is equality of bargaining power between the parties, an exclusion clause that leaves the innocent party with no meaningful remedy is likely to be void.

However, in the Court of Appeal ([2008] EWCA Civ 361) the judge overruled the trial judge on the basis that he had misinterpreted the exclusion clause; in particular, the licensee could still claim damages for the difference between the value of the offices with air-conditioning and their value without, or just reduce the licence fee accordingly.

The licensee also claimed for relocation costs and for loss of business. However, the Court of Appeal upheld the licensor's exclusion of all liability in respect of "loss of business, loss of profits, loss of anticipated savings, loss of or damage to data, third party claims or any consequential loss" on the basis that there was equality of bargaining power between the parties and it was reasonable to expect occupiers to arrange their own insurance cover for business interruption.

Another factor in favour of the clause being found to be reasonable was the provision that firstly allowed claims of up to £1m in respect of loss to personal property, and secondly capped claims for other losses and costs at the higher of £50,000 or 125% of the licence fees paid to date. This shows that it will not always be reasonable to exclude such loss completely, especially where it is easier and

more cost-effective for the landlord to insure against it than the tenant.

Advice on drafting exclusion clauses

When drafting, you should think about the following issues:

- The clause in question must be clear and unambiguous, and incorporated into the contract. It must be signposted clearly and must evidently cover the breach in question, bearing in mind that it will be construed against the person seeking to rely on it.
- Under UCTA, an exclusion clause is enforceable only to the extent that it is reasonable. The extent to which UCTA applies to property contracts is somewhat unclear. Schedule 1 of the Act provides that it does not apply in so far as the contract relates to "the creation or transfer of an interest in land, or to the termination of such an interest." However, when drafting exclusion clauses, it is advisable to assume that this "carve-out" will be interpreted narrowly, meaning that UCTA should be borne in mind in relation to all clauses not directly relating to the creation or transfer of an interest in land. Reasonableness is judged by reference to factors including:
  - the relative bargaining strength of the parties;
  - whether the other party was given an inducement to agree to the exclusion clause;
  - whether the other party could have contracted with a different counterparty on terms that would not have included such a clause;
  - whether the other party knew, or ought reasonably to have known, what the exclusion clause meant (bearing in mind any trade custom and previous dealings between the parties); and
  - whether the other party could have insured itself against the relevant loss.
- The courts have sometimes viewed all the exclusion and limitation provisions as part of an overall liability package, which has led to them refusing to sever any offending clauses so as to leave the remaining clauses standing. It is therefore important to avoid drafting a range of alternative provisions and instead keep your clauses simple and fair, and make it clear that any global cap is intended to be freestanding.
- In terms of the loss suffered, a distinction is made between direct loss, which is all loss flowing directly and naturally from the breach, and indirect or consequential loss, which is all loss other than direct loss. If seeking to exclude liability for loss of profit, for example, make sure that this is set out as a separate head of loss and not defined as a sub-category of indirect and consequential loss, because depending on the circumstances, it can be both a type of direct loss and a type of indirect loss.
- As a general guideline, financial limits should bear some relation to the loss likely to be suffered by the other party and the extent to which insurance is available.
- If imposing time limits for notifying contractual claims, err on the generous side in order to establish reasonableness.
- Avoid excluding liability for loss due to fraud, or death or personal injury caused by negligence, as such exclusions are prohibited. From the aggrieved party's point of view, a claim for fraudulent misrepresentation is sometimes the only way to bring an action (as in *Henry Boot*) and the advantage of such a claim is that it often bypasses the contractual caps on liability (as in *BSkyB Ltd* v *HP Enterprise Services UK Ltd* [2010] EWHC 86 (TCC)) but is much more difficult to prove.

Careful consideration needed

Most commercial property contracts contain an exclusion or limitation clause in some form, but their very familiarity can lull practitioners into forgetting how carefully they need to be considered.

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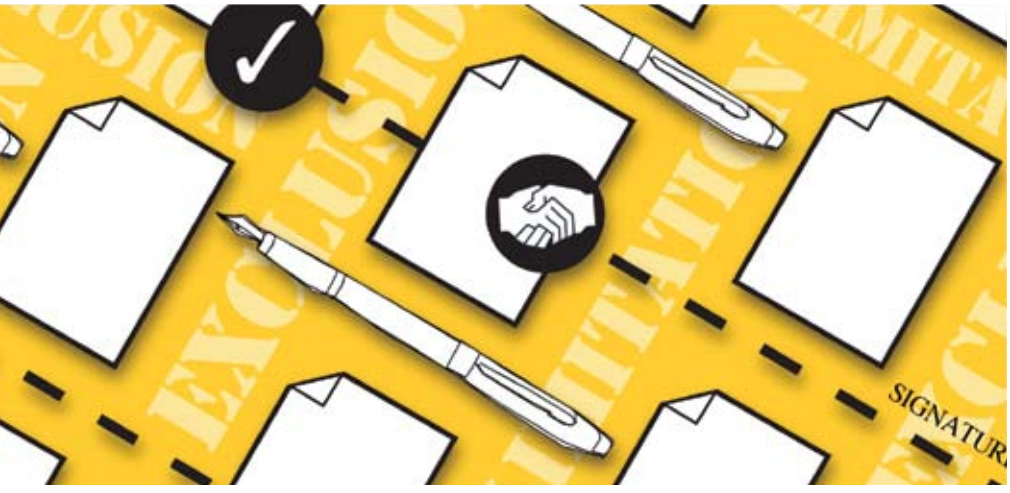

WHY THIS MATTERS

If one party has breached the terms of a contract, the aggrieved party will have to consider whether the terms of the exclusion or limitation clause prevent it from bringing an action for damages or taking steps to bring the contract to an end.

Sometimes, especially in complex construction, PFI or services contracts, documents will include a financial model setting out how much the wronged party will be entitled to claim in each of a number of scenarios.

In more straightforward property contracts, the aggrieved party will look to see whether liability for the breach that has taken place is capped or limited in the contract. If so, they should consider whether there are any statutory or common law rules to assist them. For example, the common law rule of *contra proferentem* (which means that exclusion and limitation clauses are to be construed strictly against the party seeking to rely on them) can work in the claimant's favour. Also, despite widespread belief to the contrary, UCTA may impose reasonableness requirements in some circumstances, even in the context of commercial property transactions where both parties are represented.

However, as will be apparent from the cases considered in this article, where exclusion and limitation clauses are upheld, they can have a dramatic effect in limiting the scope of the aggrieved party's remedies. Buyers and tenants should therefore consider carefully whether they can live with the effect of such provisions. In particular, it will often be advisable to seek to incorporate any significant pre-contractual statements into the contract and to ensure that meaningful levels of recovery are possible for the types of loss most likely to be suffered.

FURTHER READING

Hadley v *Baxendale* (1849) 9 Exch 341

Regus (UK) Ltd v *Epcot Solutions Ltd* [2008] EWCA Civ 361

Exclusion Clauses and Unfair Contract Terms
Dr Richard Lawson, (10th ed)
Sweet & Maxwell

Chitty on Contracts
(30th Ed), chapter 6 – Misrepresentation,
Sweet & Maxwell