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WHERE AN EXCLUSION CLAUSE IS UNREASONABLE ONLY IN PART

Stewart Gill Ltd. v. *Horatio Myer & Co. Ltd.*[1]

IN *Stewart Gill Ltd.* v. *Horatio Myer & Co. Ltd.* (*"Stewart's* case") the defendants, who were manufacturers of beds, had entered into a contract with the plaintiffs under which the plaintiffs were to supply and install for them a "twintrack power and free overhead conveyor system". The plaintiffs, having installed the system, sought to claim by summary judgment the balance of the contract price left unpaid by the defendants. The defence to the action was founded on alleged breaches of the contract by the plaintiffs giving rise to a cross claim which exceeded the amount still owing by the defendants to the plaintiffs. The contract was on the plaintiffs' written standard terms of business and included a term (Clause 12.4) which read as follows:

> 12.4 The Customer shall not be entitled to withhold payment of any amount due to the Company under the Contract by reason of any *payment credit set off counterclaim allegation of incorrect or defective Goods or for any other reason whatsoever* which the Customer may allege excuses him from performing his obligations hereunder. (Emphasis added.)

The plaintiffs relied on this clause, and it was conceded by the defendants that if the clause survived the rigours of the Unfair Contract Terms Act 1977 (U.C.T.A.),[2] the plaintiffs would be entitled to summary judgment. The defendants relied on sections 3, 7 and 13 of the U.C.T.A.[3] in support of their argument that the plaintiffs ought not to be entitled to rely on the

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1 [1992] 2 All E.R. 257.

2 c.50.

3 The relevant sections contain the following provisions:
3.-(1) This section applies as between contracting parties where one of them deals as consumer or on the other's written standard terms of business.
(2) As against that party, the other cannot by reference to any contract term –
(a) when himself in breach of contract, exclude or restrict any liability of his in respect of the breach; or

clause. From the statement of the facts by Lord Donaldson M. R. in the Court of Appeal, it would appear that the trial judge held that neither section 3 nor section 7 was applicable but that section 13 did apply. On the issue of reasonableness, he held that there was insufficient evidence to enable him to make a ruling. He therefore gave the defendants unconditional leave to defend. It was from this ruling that the plaintiffs appealed.

On appeal, Lord Donaldson held that to give unconditional leave to defend without first deciding whether the reasonableness requirement had been satisfied was to render Clause 12.4 nugatory. He held that the trial judge ought to have reached a decision on the reasonableness of the clause in the light of such evidence as he then had.

The court observed that Clause 12.4 excluded the defendants' right to set off their claims against the plaintiffs' claim for the price and further

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(b) claim to be entitled-

(i) to render a contractual performance substantially different from that which was reasonably expected of him, or

(ii) in respect of the whole or any part of his contractual obligation, to render no performance at all,

except in so far as (in any of the cases mentioned above in this subsection) the contract term satisfies the requirement of reasonableness.

7.-(1) Where the possession or ownership of goods passes under or in pursuance of a contract not governed by the law of sale of goods or hire-purchase, subsections (2) to (4) below apply as regards the effect (if any) to be given to contract terms excluding or restricting liability for breach of obligation arising by implication of law from the nature of the contract.

(2) As against a person dealing as consumer, liability in respect of the goods' correspondence with description or sample, or their quality of fitness for any particular purpose, cannot be excluded or restricted by reference to such a term.

(3) As against a person dealing otherwise than as consumer, that liability can be excluded or restricted by reference to such a term, but only in so far as the term satisfies the requirement of reasonableness.

(4) Liability in respect of-

(a) the right to transfer ownership of goods, or give possession; or

(b) the assurance of quiet possession to a person taking the goods in pursuance of the contract, cannot be excluded or restricted by reference to any such term except in so far as the term satisfies the requirement of reasonableness.

(5) This section does not apply in the case of goods passing on a redemption of trading stamps within the Trading Stamps Act 1964 or the Trading Stamps Act (Northern Ireland) 1965.

13.-(1) To the extent that this Part of this Act prevents the exclusion or restriction of any liability it also prevents –

(a) making the liability or its enforcement subject to restrictive or onerous conditions;

(b) excluding or restricting any right or remedy in respect of the liability, or subjecting a person to any prejudice in consequence of his pursuing any such right or remedy;

(c) excluding or restricting rules of evidence or procedure;

and (to that extent) sections 2 and 5 to 7 also prevent excluding or restricting liability by reference to terms and notices which exclude or restrict the relevant obligation or duty.

(2) But an agreement in writing to submit present or future differences to arbitration is not to be treated under this Part of this Act as excluding or restricting any liability.

excluded the remedy, which they would otherwise have had, of enforcing their claims against the plaintiffs by means of a set-off. It also excluded or restricted the procedural rules as to set-off. The court therefore held that Clause 12.4 was a clause which fell within the ambit of section 13 of the U.C.T.A.

The court made it clear that section 13 of the U.C.T.A. was meant to extend the scope of the provisions in Part I of the Act which included sections 3 and 7. Hence although sections 3 and 7 were expressly concerned with terms which attempted to exclude or limit liability, when read with section 13, the nets cast by these sections became considerably enlarged. The court found it clear, on the facts before it, that sections 3 and 7 were applicable to Clause 12.4 when read in the light of their enlarged scope by virtue of section 13. The clause therefore had to satisfy the Act's requirement of reasonableness in order to be enforceable against the defendants.

This interpretation of section 13 of U.C.T.A. is undoubtedly correct. The section after all opens with the words: "To the extent that this Part of this Act prevents the exclusion or restriction of any liability, it also prevents...." This must therefore also mean that to the extent that Part I of the Act does *not* prevent the exclusion or restriction of any liability, section 13 would also not prevent the same. In other words, any attempt to strike down a clause through the invocation of section 13 alone is doomed to failure. For this purpose, section 13 cannot stand on its own and has to draw life from the other substantive sections in Part I of the Act. It would therefore have been technically wrong if the trial judge had found section 13 to be applicable in isolation while ruling sections 3 and 7 to be inapplicable, as the judgment of Lord Donaldson would seem to suggest.[4] This however, is not likely to have been the conclusion reached by the trial judge since if this had been so, he would not have found it necessary to raise the issue of the reasonableness of Clause 12.4. After all, section 13 does not lay down any requirement of reasonableness. What the trial judge must therefore have meant was that sections 3 and 7 had no application apart from section 13.

Perhaps the greatest significance of this case lies in its holding that, in determining whether a term satisfies the requirements of reasonableness for the purposes of the U.C.T.A., the term in question should be considered as a whole. The court should not merely consider whether the part of the term that the plaintiffs are seeking to rely on satisfies the requirement of reasonableness. The Court of Appeal based such a conclusion, *inter alia,* on the wording of section 11(1) of the U.C.T.A. which states that:

> In relation to a contract term, the requirement of reasonableness for the purposes of this Part of this Act ... is that the term shall have

[4] [1992] 2 All E.R. 257 at p. 259.

> been a fair and reasonable one to be included 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."

This presumes that the parties would be able to assess the reasonableness of the term at the time of contracting. The court therefore reasoned that the circumstances to be taken into account in determining the reasonableness of a term could not be dependent on the particular use which one party might subsequently wish to make of the term.

Lord Justice Stuart-Smith finally confirmed in writing what the courts have been known to practise all along. He said that although Schedule 2 of the U.C.T.A. was expressly stated to apply only in relation to sections 6 and 7 of the Act, the considerations set out therein were usually regarded as being of general application to the question of reasonableness. Drawing from that conclusion, he held that paragraphs (b) and (c) of Schedule 2 would be unworkable if the requirement of reasonableness was not applied to the term under scrutiny in its entirety. In particular, paragraph (b) provides that the court should take into account:

> ... whether the customer received an inducement to agree to the term, or in accepting it had an opportunity of entering into a similar contract with other persons but without having to accept a similar term.

He therefore reasoned that it would be impossible to determine whether the "inducement" related only to the part of the term which the party seeking to establish reasonableness intended to rely on or to the rest of the term which he sought to delete. He also reasoned that it would be impossible for the party against whom the term was to be enforced to divine which part of the term the other party would subsequently seek to rely on so as to determine whether he could have contracted with some third party without incorporating such part of the term into such other contract.

Paragraph (c) of Schedule 2 to the U.C.T.A. provides that the court should take into account the question of:

> ... whether the customer knew or ought reasonably to have known of the existence and extent of the term (having regard, among other things, to any custom of the trade and any previous course of dealing between the parties).

Lord Justice Stuart-Smith reasoned that it would be impossible for the customer to determine the "extent" of a term at the time the contract was formed, if the party is entitled, when questioned as to its reasonableness, to rely on only a part of the term.

The court finally concluded that regardless of the reasonableness of a term which excluded or restricted the right of set-off, nothing could *prima facie* be more unreasonable than a term preventing the defendants from withholding payment to the plaintiffs for any amount due to the plaintiffs under the contract by reason of a "credit" owing by the plaintiffs to the defendants and *a fortiori* a "payment" made by the defendants to the plaintiffs. The concluding words of the term in question further prevented the defendants from withholding payment "for any other reason whatsoever". This, the court found to be so wide that it would even have precluded the defendants from refusing to pay on a defence based on fraud. Although the plaintiffs were not relying on these parts of the term, the court held that in determining the reasonableness of the term, the term had to be judged in its entirety. Clause 12.4 was consequently found to be unreasonable and unenforceable against the defendants.

In the light of this ruling, the obvious question that comes to mind is whether *Stewart's* case precludes any form of severance of a term which would fail a test of reasonableness if taken as a whole but parts of which would still satisfy the test. For instance, if a clause excluded liability of a party in certain situations and limited the party's liability in others, would it be possible to enforce the part of the clause which limited liability if it is found to be reasonable, notwithstanding the fact that the part of the clause purporting to exclude liability has been found to be unreasonable? There is some indirect authority in the case of *R.W. Green Ltd.* v. *Cade Bros. Farms*[5] ("*Green's* case") to suggest that the part of the clause which limits liability would still be enforceable. Although this case involved an interpretation of section 55 of the Sale of Goods Act 1893[6] ("S.G.A. 1893"), there are striking similarities between section 55 of the S.G.A. 1893 and the U.C.T.A.'s requirement of reasonableness.

Section 55(4) of the S.G.A. 1893 states that a term in a non-consumer contract of sale of goods exempting liability implied by sections 13, 14 or 15 of the S.G.A. 1893 shall:

> ... not be enforceable to the extent that it is shown that it would not be fair or reasonable to allow reliance on the term.

While this requirement of reasonableness may be phrased in the "negative" unlike the "positive" requirement of reasonableness peppered throughout the provisions of the U.C.T.A., the two are in substance the same. Furthermore, section 55(5) of the S.G.A. 1893 goes on to state that:

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[5] [1978] 1 Ll. Rep. 602.

[6] 56 & 57 Vict., c. 71, as amended by s. 4, Supply of Goods (Implied Terms) Act 1973 (c. 13).

In determining for the purposes of subsection (4) above whether or not reliance on any such term would be fair or reasonable regard shall be had to all the circumstances of the case and in particular to the following matters –

(a) the strength of the bargaining positions of the seller and buyer relative to each other, taking into account, among other things, the availability of suitable alternative products and sources of supply;

(b) whether the buyer received an inducement to agree to the term or in accepting it had an opportunity of buying the goods or suitable alternatives without it from any source of supply;

(c) whether the buyer knew or ought reasonably to have known of the existence and extent of the term (having regard, among other things, to any custom of the trade and any previous course of dealing between the parties);

(d) where the term exempts from all or any of the provisions of sections 13, 14 or 15 of this Act 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;

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

It is relevant to note that these five considerations are almost identical and similar in all material respects to the guidelines set out in Schedule 2 of the U.C.T.A. for the application of the test of reasonableness under the U.C.T.A.. Yet the court in *Green's* case did not find paragraphs (b) and (c) of section 55(5) of the S.G.A. 1893 to be obstacles in the path of its decision to enforce part of a term while holding another part of it to be unreasonable. Admittedly, there is no equivalent of section 11(1) of the U.C.T.A. in section 55 of the S.G.A. 1893. It is however submitted that this is not a material distinction to be made between *Stewart's* case and *Green's* case. It is clearly implicit from the guidelines set out in section 55(5) of the S.G.A. 1893 that the point of reference intended by the section is (as in section 11 of the U.C.T.A.), the time when the contract was entered into.

It is submitted that the test of reasonableness laid down in *Stewart's*

case should be limited to cases where a particular indivisible segment of a clause may be either reasonable or unreasonable, depending on the manner and extent to which a defaulting party may subsequently try to rely on it. For instance, a clause in a contract for the supply of goods and services may attempt to exclude the liability of the supplier for "any damage howsoever caused". While it may not be reasonable to allow the supplier to rely on this clause to exclude its liability for any damage arising from deliberate acts of malice on the part of its servants, it may not be unreasonable to allow the supplier to rely on the clause where the damage results from a latent defect in the goods supplied in the course of rendering the service contracted for, in cases where the supplier is not the manufacturer of these goods. In such cases, the ruling in *Stewart's* case that the reasonableness of a clause is to be determined by considering the clause in its entirety, ought to apply. Such a clause should therefore be deemed not to satisfy the requirement of reasonableness under the U.C.T.A. However, in the case where a clause is clearly intended to exclude or limit liability under several distinct and independent circumstances, it is submitted that the ruling in *Stewart's* case should not be applied where one party seeks to rely only on a segment of the clause which satisfies the requirement of reasonableness under the U.C.T.A. even though other segments of the clause may not meet this requirement. Instead the approach of Mr Justice Griffiths in *Green's* case ought to be applied. Such an approach would not be entirely foreign to contract law. In fact, it would be similar to the long recognised "blue-pencil test" employed for the severance of contract clauses which may be void only in part on the ground of illegality. It should be noted that although *Stewart's* case is a decision of the English Court of Appeal while the decision in *Green's* case is a first instance decision from the same jurisdiction, the latter was not even referred to in *Stewart's* case, let alone overruled.

It is conceded that such an approach would not be entirely consistent with the decision in *Stewart's* case since the case appeared to be concerned with a clause which was clearly divisible into distinct and independent parts. Nonetheless, it is submitted that *Stewart's* case ought not to be followed for the following reasons. First, to enforce part of a clause which satisfies the requirement of reasonableness under the U.C.T.A. even though the rest of the clause may not satisfy the same requirement is not completely without statutory justification. After all, nowhere does the Act render any term which does not satisfy the requirement of reasonableness void. In fact, the Act states in several places that a party may not exclude or limit liability by reference to a term *"except in so far as"* the term satisfies the requirement of reasonableness.[7] This suggests that to the extent that a term does satisfy the Act's requirement of reasonableness, it may still be relied upon.

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[7] Ss. 2(2), 3, 4, 6(3), 7(3) and 7(4). (Italics added.)

Secondly, with this first point in mind, the arguments raised by the judges in *Stewart's* case based on section 11(1) and paragraphs (b) and (c) of Schedule 2 to the U.C.T.A. are hardly convincing. What problems could there be in determining whether parts of a contract term are reasonable at the time a contract is formed, if the term comprises clearly distinct and independent parts? The requirement of section 11(1) of the U.C.T.A. and the guidelines set out in Schedule 2 to the Act would not pose any problems in the case of such a term.

For instance, if an inducement has been given to a contracting party in return for accepting a contract term which comprises two clearly distinct and independent parts, one of which is "unreasonable" and the other "reasonable", it can only mean that such a party can no longer subsequently allege that it would be unfair to enforce the "unreasonable" part of the clause. Surely then, *a fortiori,* he should not have any cause for complaint if it is the "reasonable" part of the clause which is sought to be enforced against him. If no inducement has been given, then the first part of paragraph (b) of Schedule 2 to the U.C.T.A. becomes irrelevant. What hardship could there then be in enforcing only the "reasonable" part of the clause against the contracting party?

Again, if a contract term comprises two clearly distinct and independent parts, one of which is "unreasonable" and the other "reasonable", what difficulty would there be in determining (in accordance with the latter part of paragraph (b) of Schedule 2 to the U.C.T.A.) whether at the time of contracting, the party accepting the term had the opportunity of contracting with another party without the "unreasonable" part featuring in this other contract? There would be even fewer problems in determining the "extent" of the term in such situations (in accordance with paragraph (c) of Schedule 2 to the U.C.T.A.).

It is conceded that section 11(1) and the guidelines in Schedule 2 to the U.C.T.A. all refer to the requirement of a "term" (as opposed to "part of a term") being reasonable. However, in view of the fact that the Act states indirectly in many instances that a term will still be enforceable in so far as it satisfies the requirement of reasonableness, it is submitted that the word "term" used in the Act was meant to be a generic reference to any stipulation of the contract and not a reference to how these stipulations may be formally grouped together in the contract document. Any other reading of the decision in *Stewart's* case would only lead to practical inconveniences which serve no useful function. In fact, the only foreseeable impact of the decision would be a change in the practice of drafting contract clauses. To be safe from the ruling in *Stewart's* case, clauses which seek to exclude or limit liability in a myriad of situations may in future be drafted not as one large clause but as many small, separate clauses to avoid the necessity of arguing for a severance of any part of a clause which may

subsequently be found to be objectionable by the court. This will promote neither efficiency in drafting nor the preservation of the environment as contract documents will then be even longer than they tend to be at present. Finally, it is submitted that taking the suggested approach and limiting the approach in *Stewart's* case to contract terms which are not clearly severable, would pose no hardship to the contracting parties.

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