

when is a contract unfair?

The two principal pieces of legislation which deal with the 'fairness and reasonableness' of contractual terms are the Unfair Contract Terms Act 1977 ("UCTA") and the Unfair Terms in Consumer Contracts Regulations 1999 ("the Regulations").

Whilst the regulations apply solely to contracts involving consumers, UCTA also applies to business-to-business contracts. This includes any contracts entered into by government departments or local authorities, which are deemed by UCTA to be acting as businesses.

What does UCTA say?

Unlike the regulations, UCTA is quite limited in its scope and does not contain a 'general rule of fairness' in respect of contract terms. Instead, UCTA places certain restrictions on terms which can be agreed in contracts and the extent to which a party's liability can be excluded or restricted.

UCTA provides that terms should be drafted in clear and unambiguous language, and in consumer contracts any ambiguity will be interpreted in favour of the consumer.

There is also a requirement for parties to deal with each other fairly and openly, and any terms which seek to protect a party's commercial objectives cannot go further than is necessary to protect those legitimate commercial interests.

What contracts does UCTA apply to?

It is worth noting that UCTA applies to all contracts except:

- insurance contracts;
- contracts for the transfer of land;
- contracts for the creation or transfer of most types of intellectual property;
- the formation or dissolution of companies; and
- the creation or transfer of a right in a security

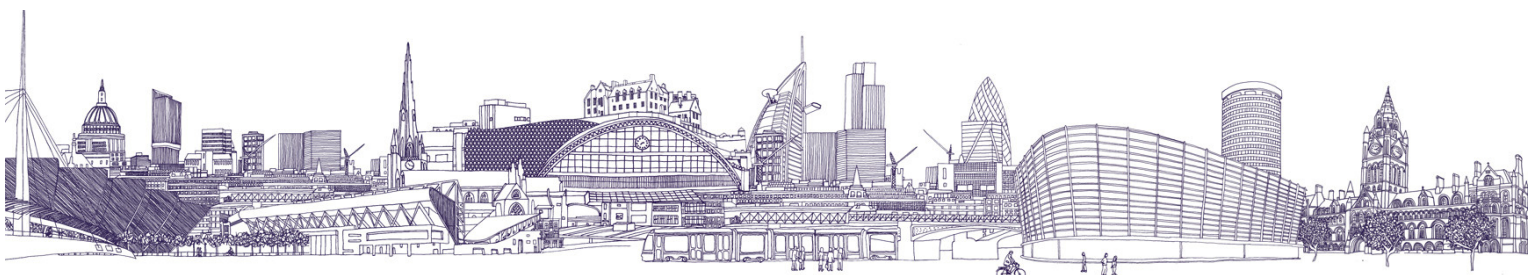
What can be excluded?

Under UCTA a party cannot exclude or limit its liability to the other party in case of death or personal injury.

In addition, a party can only exclude or limit its liability for any losses the other party suffers due to its negligence or due to defective or poor-quality goods if it is reasonable for it to do so (except in a consumer contract when these liabilities can never be excluded irrespective of whether it is reasonable).

If a contract does contain a term excluding or limiting a party's liability, just because the other party was aware of the exclusion is not taken as voluntary acceptance of it.

UCTA also provides that some of the terms which are automatically implied into a contract by the Sale of Goods Act 1979 cannot be excluded. For example, a party can never exclude liability relating to title of goods and can only exclude liability relating to description, quality, fitness for purpose or sample where it is reasonable to do so.



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What about standard terms?

If the parties have contracted using a standard form contract (i.e. the contract terms have not been amended or negotiated), UCTA will also restrict a party's ability to:

- exclude or limit its liability for breach of contract;
- provide substantially different performance to that reasonably expected; or
- provide no performance at all

In the recent case of *Yuanda (UK) Co Limited v WW Gear Construction Limited* the High Court considered what constitutes a negotiated contract. The judge determined that if only minor amendments are made to what are otherwise a party's standard terms of contract, then the parties will nevertheless be deemed to have dealt on standard terms and UCTA will therefore apply.

However, if any major changes are made to the standard terms such that the terms of the parties' relationship are materially affected, then the agreement will not have been on standard terms and the court will consider this to have been an individually negotiated contract.

How will the Court determine whether a term is reasonable?

As we have seen many types of exclusion clause will only be allowed if they are reasonable. There is no actual definition of what constitutes reasonableness, but Section 11 of UCTA sets out the guidelines which the Courts should follow in making an assessment.

A contract term will be deemed to be unreasonable if, at the time that the contract was entered into, the term in question would not have been considered to be fair and reasonable having regard to the parties' knowledge. This is therefore an objective test based on the particular circumstances between the parties at the time, not with hindsight of any events which in fact occurred.

It is important to note that the burden is on the party seeking to enforce the term in question to show that it was reasonable, rather than on the 'aggrieved' party to demonstrate why the term was unreasonable.

Additionally, Schedule 2 of UCTA gives further guidance on what is reasonable in business-to-business contracts. For these contracts, the court will take into consideration:

- the relative bargaining strengths of the parties, taking into account whether alternative suppliers were available to the purchaser;
- the information which was available to both parties at the time that the contract was drawn up and entered into;

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- whether any inducement was offered to one party to enter into the contract, for example if they were given the opportunity to pay a higher price without the particular exclusion clause;
- whether the customer knew or ought to have known of the term and whether such terms are in general use in a particular trade;
- where exclusion relates to non-performance of a condition, whether it was reasonably practicable to comply with the condition;
- in respect of goods, whether the goods were made or adapted to the special order of the customer; and
- whether one party would have been able to obtain the same or similar goods or services from an alternative supplier or provider - i.e. did they have a reasonable choice of whether to enter into the contract in question or could they have gone elsewhere?

If you would like to discuss any of the issues raised in this update, please contact:



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