

**THE LAW REFORM COMMISSION OF HONG KONG**

**REPORT ON**

**THE CONTROL OF EXEMPTION CLAUSES**

**[TOPIC 13]**

We, the members of the Law Reform Commission of Hong Kong,  
present our report on The Control of Exemption Clauses.

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# THE LAW REFORM COMMISSION OF HONG KONG

## REPORT ON

## THE CONTROL OF EXEMPTION CLAUSES

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# 1. Introduction

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## Terms of reference

1.1 On 30th August 1983, the Chief Justice and the Attorney General referred to the Law Reform Commission the following question :-

*"To what extent is legislation necessary or desirable in Hong Kong to relieve a party to a contract from the consequence of harsh or unconscionable express terms, including terms excluding or limiting liability for breach of primary obligations?"*

1.2 In the course of its deliberations, the sub-committee appointed by the Law Reform Commission to examine this subject concluded that the scope of the study should be restricted to exemption clauses. Other aspects of the area covered by the terms of reference could more appropriately be incorporated in a wideranging review of consumer legislation. Accordingly, this report, and the sub-committee report on which it is based, concerns itself only with the control of exemption clauses.

## Sub-committee membership

1.3 A sub-committee was appointed under the chairmanship of Mr. Arjan Sakhrani, Q.C., J.P., a member of the Law Reform Commission, and held its first meeting in November 1983. The full membership of the sub-committee is to be found at Annexure 1.

## Method of working

1.4 The sub-committee met on 7 occasions. In April 1984, a Working Group composed of some members of the sub-committee was established and its membership is shown at Annexure 2.

1.5 The sub-committee actively sought the views of interested individuals and organizations. In November 1983, a press release was published in both the English and Chinese press. In February 1984 a letter was sent to various local bodies seeking their views on the need for control of exemption clauses. The organisations who were invited to comment, together with an indication of those who responded and the firms and individuals who volunteered comment, are shown at Annexure 3.

1.6 In addition to consulting widely, the sub-committee considered an extensive range of material and this is recorded at Annexure 4. In particular, the English Unfair Contract Terms Act was considered in detail with

a view to the possible adoption of similar provisions in Hong Kong and the text of the Act appears at Annexure 5.

1.7 In May 1985, a Working Paper was circulated by the sub-committee to the individuals and organisations listed in Annexures 3 and 6.

1.8 In January 1986, the sub-committee submitted its report to the 40th Meeting of the Law Reform Commission and the Commission considered the subject at the 41st, 42nd, 43rd, 44th, 46th and 47th Meetings.

## **2. The part played by exemption clauses in contract**

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2.1 This Report is concerned with provisions which seek to exclude or restrict a legal duty or obligation owed by one person to another. Such provisions are known as "exemption clauses" and arise most commonly in relation to contracts. Before considering whether there is a need to control exemption clauses it may be helpful to examine the basic law of contract and the effect of exemption clauses upon it.

### **The nature of a contract**

2.2 A contract is an agreement between 2 or more persons intended to create a legal obligation between them and to be legally enforceable. The essentials of a valid contract are that the parties must have had contractual capacity; must have reached agreement on all the material terms of the contract; must have intended the agreement to be legally enforceable, as opposed to merely a social or moral obligation; and the agreement must not be objectionable by virtue of illegality, impossibility, or the fact that it is contrary to public policy. Some particular kinds of contract may require to be drawn up in a specific form. In addition, under English law, there must generally be some consideration for the contract.

2.3 In effect, a contract is an exchange of promises between the parties. Once these promises are exchanged, a binding contract will come into being and the law will enforce that contract.

If, for example, A promises to sell his car to B, the promise of a car is made in return for the promise of the payment of the price and vice versa. However, there may be other promises made. It may be that B agrees to pay in advance, or in US dollars, or that A agrees to deliver the car to B's door, or to continue to service it for a year. These are express agreements.

2.4 Besides such express terms, contracts frequently contain terms which have not been expressly stated. These are known as implied terms. Thus, by virtue of the provisions of the Sale of Goods Ordinance (Cap. 26). A impliedly promises B that the car is his to dispose of, that it is as described and (if A is in business as a dealer in motor cars) that it is merchantable and fit for its purpose.



## Breach of contract

2.5 The exchange of promises provides the parties with certainty as to the scope and meaning of the contract and provides each party with the security of a remedy if the other party fails to fulfil his part of the bargain. Breach of contract is the failure by either party to implement any of the duties imposed upon him by the contract. The breach will entitle the party not in breach to a claim of damages in compensation or, if the breach is in respect of a fundamental element of the contract, to treat the contract as at an end and to recover damages for its failure. The remedy available (damages, or discharge of the contract and damages) will depend on the nature of the breach.

For example, if A does not deliver the car, B may refuse to pay, or if he has already paid he may demand back the entire price and treat the contract as at an end. If he has suffered further loss (for instance, if the car was a taxi and A knew B needed it to start business) then B may claim monetary damages as well as the price. If the car will not go at all, B can refuse to pay. However, if the seat covers are the wrong colour, then usually B will have to pay the price less the amount of damages needed to set the minor breach right.

## The appropriate remedy

2.6 The question whether or not a party may refuse to proceed with performance of the contract may be important.

For example, if A engages B to sing in a concert and B refuses to attend any rehearsals, A might want to employ another singer. He could only do this without liability to B if B's breach were sufficient to warrant A's treating the contract as discharged. If the breach were not sufficiently serious then A might find himself liable to B for his breach in engaging another singer instead of B. Such considerations underlie 3 cases - Bettini v Gye<sup>1</sup> Lumley v Wagner<sup>2</sup> and Poussard v Spiers<sup>3</sup>.

2.7 The courts used to classify all contractual terms as either conditions or warranties. A condition is an essential term of the contract, whereas a warranty is a minor term. For breach of a condition by one party, the other party could refuse to perform his side of the contract, whereas for breach of a warranty he would still have to perform. In both cases, damages would be available. The courts now recognise a third type of contractual term, known as an innominate term. Whether a breach of such a term will entitle the innocent party to treat the contract as at an end depends on all the circumstances, including the results of the breach. In all cases, a party can

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<sup>1</sup> [1876] 1 QBD 183

<sup>2</sup> 21 L.J. Ch. 898

<sup>3</sup> [1876] 1 QBD 410

lose the right to treat himself as discharged by affirming the contract (i.e., treating it as still in existence).

If B bought shoes from A which fell apart on first wearing, B would have a right to get his money back. However, if B went back to A and had the shoes repaired and then they fell apart again, B would not be able to resile from the contract for the original breach. He would only be able to sue for damages.

## **The place of the exemption clause**

2.8 A widespread feature of written contracts is that the party tendering the document will seek to limit his liability under the contract (or for a tort connected with the contract) either wholly or in part. He does this by the use of an exemption clause.

2.9. Chitty ("Contracts", 25th Edition) suggests that exemption clauses may be divided into 3 types. First, there are those which purport to limit or reduce what would otherwise be the defendant's duty (for example, by excluding express or implied terms). Second, there are clauses which purport to exclude or restrict the liability which would otherwise attach to a breach of contract (such as the liability for damages) or which take away from the other party the right to treat the contract as repudiated or to rescind. The third type are clauses which purport to exclude or restrict the duty of the party in default fully to indemnify the other party (for example, by limiting the amount of damages recoverable).

2.10 The effect of an exemption clause is to change the nature of the contract. In a contract, A says to B, "I will do x if you will do y. If I do not do x, you may seek your remedies". Where there is an exemption clause, the second sentence no longer applies in an unqualified manner. An exemption clause seeks to modify A's liability, either by total exclusion or by limitation. A may say, "You will have no remedy". For instance, the owner of a car park may seek to incorporate in his contract with those using the car park, a statement that "Cars parked in this car park are parked entirely at the owner's risk and the management will not be responsible for any loss or damage howsoever caused".

2.11 A may more modestly say "Your remedy is not absolute. "For example, an exemption clause may restrict B to damages where he would otherwise have had a right to treat himself as discharged, or it may impose some limit in money or time such as, "Claims for lost laundry limited to \$5 per item", or, "The company will not honour any claim unless received within 7 days of the accident".

2.12 For the purpose of this report, exemption clauses may be described as those terms that exclude or restrict obligations or liability or rights and remedies. Some are manifestly designed to achieve one or more

of those objects. Others, although apparently intended for some other purpose, may be capable of having the same effect.

2.13 In our view the following would clearly operate as exemption clauses :

- (a) terms imposing a liability in consequence of the exercise of a right or remedy;
- (b) terms imposing a time-limit shorter than that fixed by the general law for the enforcement of a right or remedy;
- (c) terms imposing a time-limit on action necessary before any right, remedy, duty or liability arises;
- (d) terms altering the onus of proof or providing that one matter is conclusive evidence of another;
- (e) any provision by virtue of which one person has to indemnify another from the consequence of the former person's having exercised a right or remedy, since such a provision restricts the exercise of the right or remedy;
- (f) any provision that a dispute is to be determined by one of the parties and that his decision is to be final;
- (g) any clause that provides for the submission of a dispute to an arbitrator before recourse to the courts, since such a clause restricts the avenues of redress available to the parties.

2.14 Exemption clauses are often used by a stronger party against a weaker or less sophisticated party. As between two parties of equal sophistication and bargaining power, an exemption clause may represent a true agreement as to the price and risk undertaken by each party; as between parties of unequal standing, such as a company and a consumer, the clause may be imposed so as to deny the customer's normal expectations. Similarly, in many cases parties have no real option but to accept the terms offered to them because of the impracticality of negotiating an amendment to the contract. It is because of these factors that the use of exemption clauses has been the subject of concern in a number of jurisdictions, not least in the United Kingdom where a joint report by the English and Scottish Law Commissions was issued in 1975.

### 3. Freedom of contract, exemption clauses and the common law

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3.1 Historically, the law relating to contract has evolved over the centuries as the product of the necessities of trade and the market economy. There has been little statutory intervention, and frequently statutory provision (such as the Sale of Goods Act 1893 or Hong Kong's Sale of Goods Ordinance, Cap. 26) has merely been a re-statement of the common law rather than a radical departure from it. The idea of a free exchange of promises (or freedom of contract) remains central to the theory of contract today. However, that freedom has been modified by the common law where, for instance, the consent of the party has been defective in some respect. Thus, the law came to the aid of persons under a disability, such as infants and the insane. Victims of fraud, too, were released from their promises because their consent could not be regarded as having been freely given.

3.2 Whilst, in theory, the basis of the law of contract remains "agreement" (a consensual meeting of intentions of both offeror and offeree), in legal reality "agreement" may be illusory. For it is not the meeting of actual intentions which prevails when determining legal duties, but the meeting of the "intentions" as stated in the contract. There exists at common law (except for the mitigatory effects of the doctrines of mistake, misrepresentation, frustration, and the control of penalty clauses), no duty to satisfy a "reasonable" expectation. It is only the contract itself which is binding.

3.3 There exists, therefore, at common law the possibility of an unwitting contracting party entering into a legally binding agreement, different from that which he intended, and which to the mind of any "reasonable man" would be wholly or partially objectionable. Yet the Courts will rarely save him from his folly, if this involves the "rewriting" of terms to which, in legal theory, he has assented. Thus, in L'Estrange v Graucob<sup>4</sup>, unread (though legible) writing in "regrettably small print" excluded any "express or implied condition, statement, or warranty statutory or otherwise" not stated in the contract. The plaintiff signed the document without being aware of this clause. It was held that she was bound by the terms of the contract she had signed and could not avail herself of an implied term. Such contractual terms could in theory purport to change the nature of the apparent agreement: they could deny liability; exclude recourse to the courts; permit the offering of a different service and so on. It is clear, especially with the contemporary prevalence of written "standard-form" contracts, that such a rule may permit an abuse of bargaining superiority which, for instance, the doctrines of mistake or misrepresentation are incapable of remedying. It should be noted that in some examples of such abuse of bargaining power, such as one party taking advantage of the temporary financial difficulties of the other, the essence of

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<sup>4</sup> [1934] 2 K.B. 394

the "disadvantage" is precisely that the unfortunate party has not the time to read the contract carefully.

3.4 The courts will not look beyond the intent of the parties as manifested in the terms of the contract itself. Thus, in Storer v. Manchester C.C.<sup>5</sup> Lord Denning M.R. said :

*"In contracts you do not look into the actual intent in a man's mind. You look at what he said and did. A contract is formed when there is, to all outward appearances, a contract. A man cannot get out of a contract by saying : 'I did not intend to contract', if by his words he has done so. His intention is to be found only in the outward expression which his letters convey. If they show a concluded contract that is enough."*

3.5 This overriding common law principle of contractual construction was cited by Lord Wilberforce in Schuler A.G. v Wickman Machine Tool Sales Ltd<sup>6</sup> in a dissenting judgment :

*"..... to call the clause arbitrary, capricious or fantastic or to introduce as a test of its validity the ubiquitous reasonable man .... is to assume, contrary to the evidence, that both parties to this contract adopted a standard of easygoing tolerance, rather than one of aggressive, insistent punctuality and efficiency. This is not an assumption I am prepared to make, nor do I think myself entitled to impose the former standard upon the parties if their words indicate, as they plainly do, the latter....."*

3.6 Although the common law cannot alter the effect of an exemption clause or ignore it, except in limited circumstances, the courts have generally looked on exemption clauses with disfavour. This judicial attitude no doubt stems from a realisation that exemption clauses are frequently used where contracting parties have unequal bargaining strengths and the weaker party is seriously disadvantaged. In some cases, the intention of the parties is not reflected in the terms of the contract. Thus, although the common law could not theoretically run counter to the parties' intentions, it devised a series of tests to identify those intentions clearly. Although not overtly aimed at controlling exemption clauses, these tests often have the effect of rendering such a clause ineffective.

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<sup>5</sup> [1974] 3 All E.R. 824 at page 828  
<sup>6</sup> [1973] 2 All E.R. 39 at page 55

## The common law tests

### *Incorporation*

3.7 The first test is to decide whether the exemption clause is part of the contract. If a contract containing the clause has been signed, then the strictures of the clause cannot be avoided (see L'Estrange v Graucob, supra.) . However, many contracts involve the use of unsigned documents, such as tickets, wall notices, etc. In such cases, the test is whether the party relying on the clause has taken sufficient steps to bring the clause to the notice of the other party before the contract is made.

In Olley v Marlborough Court Ltd.<sup>7</sup>, a notice in the hotel bedroom stated: "The proprietors will not hold themselves responsible for articles lost or stolen, unless handed to the manageress for safe custody." On the theft of Mrs. Olley's furs and jewellery (which had been left in her bedroom) the hotel sought the protection of the exemption clause.

It was held that the contract between the hotel and its guests was made, at the latest, at the reception desk, and that the guests could not have been given notice of the exemption clause before the contract was made. Accordingly, the hotel could not rely on the exemption clause.

3.8 However, if Mr and Mrs Olley had been regular guests at the hotel and if the notice had been displayed on each occasion they might, after a "consistent course of dealing", have been bound by the clause, since they would have had the opportunity to read it before the current contract was entered into. This argument was adopted in J. Spurling Ltd. v Bradshaw<sup>8</sup>, where the clause was printed on an invoice, given when the transaction in question was complete. As there had been a series of transactions on the same terms the clause was deemed to be incorporated in the contract.

3.9 This may be contrasted with the approach in McCutcheon v. Macbrayne Ltd.<sup>9</sup> where there was no written document but the pursuer was aware of certain conditions, though not their precise nature. It was held that in the absence of any contractual documents, the pursuer could not by a course of previous dealing, be bound by conditions of which he was generally aware but the specific terms of which he had no knowledge.

3.10 Even if the clause is written and is actually presented to the second party before contract, this may not necessarily amount to "sufficient notice". The test depends on the nature of the document as well as the time of presenting it and the nature of the clause. For example, if a party regards a document as a mere receipt or (as with some tickets) as a means of evidencing his right to reclaim an item, it may be necessary to have some form of notice of the exemption clause in addition to the document.

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<sup>7</sup> [1949] 1 K.B. 532

<sup>8</sup> [1956] 2 All E.R. 121

<sup>9</sup> [1964] 1 W.L.R. (H.L.) 125

3.11 Where terms are printed on the back of the ticket, it is necessary to give notice on the front of the ticket "for conditions see back". In English law, the most severe case (against the consumer) is probably Thompson v L.M. & S. Railway Co.<sup>10</sup>.

In that case, an illiterate old lady sent her niece to buy her a ticket for a special railway excursion.

The ticket contained the words "for conditions see back". On the back there was a reference to the fact that conditions could be found in the timetable (which was on sale). It was held that the old lady, through her agent, had sufficient notice. It was a special excursion and she should have been aware that there would be special conditions.

3.12 This approach has been roundly rejected in Hong Kong. Here, there is a tendency to put a much stronger onus on the party relying on the exemption clause.

In the recent case of Yung Oi-King v Beautcity Restaurant Ltd<sup>11</sup>, which was concerned with a restaurant's parking service, the plaintiff admitted he knew that restaurants usually covered themselves against liability when offering such a service. Nevertheless, the court was satisfied that the particular term had not been brought to his notice and found in the plaintiff's favour.

3.13 This followed the reasoning of the court in Wong Wai-chun v The China Navigation Co. Ltd<sup>12</sup>, where Hogan C.J. said (at page 495) :

*"If the carrier had taken steps reasonably sufficient to give [the passenger] notice that such a condition formed part of their contract then the passenger was equally bound even if he did not know the terms of the condition because he had not availed himself of the opportunities open to him of ascertaining the terms. What is reasonably sufficient notice in any given case is to be determined as a matter of fact in the light of its own particular circumstances, which, within limits, may include the personal characteristics of the passenger or his agent."*

3.14 In Yung Oi-king v Beautcity, actual notice was not deemed to have been given because the ticket presented to the plaintiff did not bear the words "for conditions see back". The question is not whether B had actual notice of the exemption clause but whether A took steps to ensure that B could, with care, have known of the clause. Hong Kong courts may lean more towards B than the English courts do, but incorporation is not a complete answer.

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<sup>10</sup> [1930] 1 K.B. 41

<sup>11</sup> High Court No. 2708/81

<sup>12</sup> [1969] H.K.L.R. 471

## **Privity**

3.15 It is a basic rule of contract that a person may neither sue nor be sued on a contract to which he is not a party. Similarly, an exemption clause will not protect a person who is not a party to the contract. The facts of Adler v Dickson<sup>13</sup> serve to illustrate the point.

A boat passenger was injured while crossing a gang plank because of the negligence of the sailors involved. She could not sue the shipping company because of an exemption clause. However, she could and did sue the sailors in the tort of negligence, because they were not personally covered by the clause. Even if the wording had purported to cover them, the court would not have allowed reliance on the exemption clause since the sailors were not parties to the original contract.

Nevertheless, in recent years carefully worded clauses have been held to cover third parties. These have not been servants, however, but independent contractors.

## **Interpretation and the contra proferentem rule**

3.16 The court construes an ambiguity strictly against the party who produced the clause, and has gone to considerable lengths to do so.

In Houghton v Trafalgar Insurance Co. Ltd<sup>14</sup> an insurance policy did not cover liability arising when the car was "conveying any load in excess of that for which it was constructed." At the time of the accident, the 5 seater car was carrying 6 persons. It was held that the exemption clause referred only to cases where there was a weight specified in respect of the load of the vehicle, as, for instance, in the case of a lorry. It could not be extended to cover the case of a private car carrying an extra passenger.

3.17 A number of cases have established that to exempt "warranties" does not exempt "conditions", to exempt "implied terms" does not apply to "express terms", etc. Nevertheless, careful drafting can overcome this hurdle. The clause in L'Estrange v Graucob<sup>15</sup> stated:

*"This agreement contains all the terms and conditions under which I agree to purchase the machine specified above, and any express or implied condition, statement, or warranty, statutory or otherwise not stated herein is hereby excluded".*

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<sup>13</sup> [1955] 1 Q.B. 158

<sup>14</sup> [1953] 2 All E.R. 1409

<sup>15</sup> See para. 3.3



3.18 The court held that the purchaser of a defective slot machine could not rely on an implied warranty that it was fit for the purpose for which it was sold since the purchaser had signed a document containing the exemption clause referred to and was therefore bound by its terms. Special and very technical rules apply to negligence, but it is possible to overcome these by making sure the clause refers to loss or damage "whether caused by negligence or otherwise" or even "howsoever caused".

3.19 Ultimately, the interpretation rule is designed to put the parties' intentions into action. The intentions are based, however, on what the parties said or did (their apparent intentions), and not on private reservations or misapprehensions. This rule can do nothing about the clause which is technically clear, but obviously unfair.

### ***Fundamental breach***

3.20 The courts developed a rule, known as the doctrine of fundamental breach, under which, if a contracting party was guilty of a breach that went to the heart of the contract so that there was a total failure to perform its obligations, it could not rely on the exemption clause to exempt it from its liabilities.

3.21 For a time, the doctrine of fundamental breach seemed to offer courts a means of controlling exemption clauses. However, the doctrine is probably no more than an aspect of interpretation. Where the breach has unlooked for and disastrous results it may be possible to argue that the clause was never intended to cover more than the usual consequences and modes of breach. The rule contained in the doctrine of fundamental breach led to the courts using fundamental breach as an excuse for introducing the concept of the reasonable clause, a factor which has no part to play in interpretation. Recently the House of Lords has criticised any attempt to introduce any such extension of the rule.

In Photo Production Ltd v Securicor Transport Ltd<sup>16</sup>, a security man sent to watch a factory deliberately burned it down. An exemption clause in the contract excluded liability by the security company for damage caused by its employees. The House of Lords held that the question as to the extent to which an exclusion clause should be applied to any breach of contract was a matter of construction of the contract. The parties should be free to apportion the risks as they thought fit. In this case, the words of the exclusion clause were clear and in their true construction covered deliberate acts as well as negligence so as to relieve the defendants from responsibility for their breach of the implied duty to operate with due regard to the safety of the premises.

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<sup>16</sup> [1980] A.C. 827

3.22 The Court of Appeal had held that the clause did not apply because the breach was fundamental. The House of Lords was doing no more than affirm its own previous statements in the case of Suisse Atlantique<sup>17</sup>. In that case it stated that whether an exemption clause could cover fundamental breach was a matter of construction and of putting into effect the parties' intentions. Although it is unlikely the clause will survive, it may if the intentions are clear enough. Photo Production<sup>18</sup> was decided after the enactment of the Unfair Contract Terms Act but the decision was made on common law grounds and reaffirms that law. It took away a latitude the courts had assumed when ruling in previous cases that it would be unreasonable to allow a fundamental breach to be covered by an exemption clause.

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<sup>17</sup> Suisse Atlantique Societe d'Armement Maritime S A. v. Rotterdamsche Kolen Centrale [1967] 1 A.C. 361

<sup>18</sup> See para. 3.21

## 4. The case for control of exemption clauses

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### General criticism of exemption clauses

4.1 The UK Law Commissions in their 1975 Report on Exemption Clauses cogently argued the case for control of exemption clauses. The Commissions were in no doubt that in many cases such clauses operated against the public interest. They went on to say :

*"All too often they are introduced in ways which result in the party affected by them remaining ignorant of their presence or import until it is too late. That party, even if he knows of the exemption clause, will often be unable to appreciate what he may lose by accepting it. In any case, he may not have sufficient bargaining strength to refuse to accept it. The result is that the risk of carelessness or of failure to achieve satisfactory standards of performance is thrown on to the party who is not responsible for it or who is unable to guard against it. Moreover, by excluding liability for such carelessness or failure, the economic pressures to maintain high standards of performance are reduced."*

4.2 The party seeking to impose the exemption clause may have the economic bargaining strength to insist on its acceptance and allow no room for negotiation. In effect he is able to say "These are the terms upon which I am prepared to make this contract – take it or leave it". By way of illustration, one example of an exemption clause commonly imposed will suffice. In relation to car parking services, it is usual to find a term along the following lines given to the car owner as he hands over his keys :

*"The Management, its servants or agents shall not in any circumstances whatsoever be responsible for or accept any liability whatsoever in respect of any damage or injury of whatever nature however caused to your vehicle, or to any person or the loss or theft of your vehicle or the loss or theft of the things in or upon your vehicle."*

In purely practical terms, it is unrealistic to expect the motorist to attempt to negotiate the terms of his contract with the car park and the management is therefore left in a position of considerable strength.

### Freedom of contract and the Chicago School

4.3 We have considered the views of those who criticize "consumer legislation" on the ground that it is too often an unjustified interference with the

efficient operation of the market forces of a free economy. The strongest proponents of such views are the economists conveniently, if not always accurately, described collectively as the Chicago School. For this school of thought, a free market economy necessarily requires freedom of contract. Any interference with the freedom of the parties to a contract to strike whatever bargain they choose distorts the delicate mechanism of that market and is justifiable only if society as a whole benefits thereby.

4.4 A fundamental assumption of the Chicago School theory is that the individual, by rational action, will always act in the way that most advantageously advances his own self interest. The individual should therefore be allowed the maximum freedom to pursue his own interest in so far as it is consistent with the interest of others. Since each individual in society is trading toward fulfilment of his self-interest, society as a whole is maximising its welfare. Thus resources will be allocated to their most highly valued use, value being defined in terms of the price an individual is willing to pay for a commodity. This the Chicago School considers is best achieved by means of the process of free exchange. It follows that there should be no external interference with that process. Few in Hong Kong would disagree with that point of view where parties are of equal bargaining strength and are able to negotiate the terms of their agreement.

4.5 The Chicagoans themselves recognise that the theory is dependent on a fiction - the existence of a perfectly functioning market mechanism, namely one that is perfectly competitive, where all the parties have perfect knowledge of the market and where the exchange process is cost free. Since the market mechanism cannot function perfectly where one of the parties has little opportunity to read the contract and usually no opportunity to negotiate its terms or where one of the parties enjoys an overwhelmingly superior bargaining position, the Chicago School concedes that some intervention by the law is desirable. No form of regulation of the process of free exchange, howsoever beneficent, is cost-free. In its view, intervention is desirable only if the gains it produces for its beneficiaries are greater than the losses it inflicts on its victims. The problem then becomes one of weighing up the "gains" and "losses" - a problem regarded by the critics of the School as insuperable.

4.6 Standard form contracts are frequently the product of the malfunctioning of the free market. As Lord Diplock remarked in A. Schroeder Music Publishing Co. Ltd. v. Macaulay<sup>19</sup>, some standard form contracts are "the result of the concentration of particular kinds of business in relatively few hands .... The terms of this kind of standard form contract have not been the subject of negotiation between the parties to it, or approved by any organisation representing the interests of the weaker party. They have been dictated by that party whose bargaining power, either exercised alone or in conjunction with others providing similar goods and services, enables him to say 'If you want these goods and services at all, these are the only terms on which they are obtainable. Take it or leave it.' To be in a position to adopt

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<sup>19</sup> [1977] 1 WLR 1308 at 1316

this attitude towards a party desirous of entering into a contract to obtain goods or services provides a classic instance of superior bargaining power.

4.7 The Chicagoans' justification for the use of the standard form contract is that it reduces transaction costs. Intervention by the law, rather than the market, to redress any inequality, they argue, would lead to increased costs that would be passed on the consumer. In other words, losses from the intervention would exceed gains. Critics of the School have pointed out that there is no evidence to support this conclusion, that it is mere guesswork.

4.8 The essential objection to any general control over exemption clauses is that such control is an unjustifiable interference with freedom of contract. In our view the objection is valid only to the extent that there is true freedom of contract to interfere with. The objection has no validity where there is no real possibility of negotiating contract terms, or where a party is not expected to read a contract carefully or to understand its implications without legal advice. It is only in those circumstances that we believe that legislative intervention is justified. We share the view of the English and Scottish Law Commissions and of the legislatures of several Commonwealth jurisdictions that in many cases exemption clauses operate against the public interest. We believe that the prevailing judicial attitude of suspicion, if not hostility, to such clauses is well founded. From the responses received from those who were consulted, we are left in no doubt that the misuse of these clauses is objectionable. Some are totally unjustified. Others may operate fairly or unfairly, efficiently or inefficiently, depending on the circumstances.

4.9 We do not believe that any legislative formula can distinguish between situations where there is genuine freedom of contract and those where there is not. Only individual scrutiny of all the circumstances to take into account the strength of the bargaining positions of the parties, the knowledge and understanding of the term in question, the extent to which one party relied on the advice or skill of the other, and every other relevant fact, can lead to a valid distinction. It is the necessity to make that distinction that is the justification for legislative intervention. The form that that intervention should take is dictated by the necessity to weigh those factors.

## **Conclusion**

4.10 We have concluded that the use of exemption clauses leads to abuse, especially where the parties are not in positions of equal bargaining strength, and we believe that the benefits of some measure of control outweigh any economic disadvantages which may be caused by this limited interference with the freedom of contract.

## 5. Statutory reform

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### England and Hong Kong

5.1 It will be clear from the outline in Chapter 3 that the common law tests do not catch the unfair but non-fraudulent clause. The tests deal with the requirement to give notice of the clause but not whether the second party received the message; they deal with putting into effect the intentions of the parties as evidenced in the contract, but the true intention of the parties may not be adequately reflected there.

5.2 Statutory control of exemption clauses in England has a long history. The early types of control dealt with clauses in particular types of contract. For example, the Railways and Canal Traffic Act of 1854 prevented railway and canal companies from contracting out of their liabilities unless the court considered the clause to be "just and reasonable". The Hire Purchase Act 1938 provided that certain implied terms relating to goods supplied on hire purchase (including the term that the goods should be of merchantable quality) could not be excluded. In 1973 controls were introduced in relation to exemption clauses in sale of goods contracts. In consumer sales the statutory implied terms could not be excluded and in other cases an exemption clause was subjected to a reasonableness test.

5.3 More recently, English statutory controls have been applied to all types of contracts. The Misrepresentation Act 1967 prevented any contracting party from excluding liability for misrepresentation except to the extent that it was reasonable for him to rely on the exemption clause. The Unfair Contract Terms Act of 1977 also applies, with very limited exceptions, to all types of contracts.

5.4 Hong Kong also has legislation dealing with exemption clauses in specific types of contracts. For example, both the Motor Vehicles Insurance (Third Party Risks) Ordinance (Cap. 272) and the Employees' Compensation Ordinance (Cap. 282) preclude an insurer from avoiding liability on the basis of an act or omission after the happening of the event giving rise to the claim. Exemption clauses in sale of goods contracts (but not hire purchase contracts) are subject to controls in the Sale of Goods Ordinance (Cap. 26) which are similar to those in England. Any exclusion or limitation of liability of an employer in respect of personal injuries to an employee is rendered void by virtue of Section 22(2) of the Law Amendment and Reform (Consolidation) Ordinance (Cap. 23).

5.5 So far as general controls are concerned, Hong Kong has the Misrepresentation Ordinance (Cap. 284) but nothing similar to the Unfair Contract Terms Act. The result is that in Hong Kong a purchaser of goods is protected, but not someone who takes those same goods on hire purchase or

simple hire. Those who use services, such as laundries, car parks, etc., are not protected at all.

5.6 It should be noted that in England the Unfair Contract Terms Act reflects a much stronger tradition of consumer protection than is the case in Hong Kong. The Director General of Fair Trading, with a government department under his control (a creation of the Fair Trading Act 1973), is charged with overseeing the working of the Unfair Contract Terms Act. In England it is an offence to use an exemption clause made void by statute – a powerful means of controlling the use of such clauses.

5.7 Clearly, interference with the operation of the free market in the interests of protecting the consumer has been more extensive in England than in Hong Kong and the social and legal backgrounds are rather different. For this reason, we do not think it appropriate for Hong Kong to adopt the English reforms wholesale. Instead, we have restricted ourselves to considering the matters contained in the English Unfair Contract Terms Act.

5.8 Because of the passing of the Unfair Contract Terms Act and subsequent developments set out in Photo Production Hong Kong is left in an awkward position. It does not have a general statutory control over exemption clauses, yet the courts have been deprived of the judicial control they formerly exercised on the basis of there being a fundamental breach of contract.

5.9 Statutory control exists only in relation to specific contracts. This is an occasion where, having gone part of the way, we should not hesitate to complete the journey. In contracts of hire, contracts for work and materials and contracts of exchange or barter, the parties are free to contract out of terms implied by the common law in favour of the hirer, the person for whom the work is provided or the person to whom goods are supplied. We see no reason why the right thus conferred by the common law should not be protected so far as is practicable in the same way as the corresponding rights are already protected in a contract of sale of goods.

## **United States of America**

5.10 In coming to our conclusions, we examined the law in other common law jurisdictions. In particular, the measures taken in the United States for consumer protection were considered. The U.S. controls in relation to consumer protection are not found in a single piece of legislation but in various laws such as section 402A of the Second Restatement of Torts, the Uniform Commercial Code and in state laws. Section 402A of the Second Restatement of Torts and some of the sections of the Uniform Commercial Code which were considered are set out below.

5.11 Section 402A of the Second Restatement of Torts provides-

*"(1) One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to*

*his property is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to his property, if -*

- (a) the seller is engaged in the business of selling such a product, and*
- (b) it is expected to and does reach the user or consumer without substantial change in the condition in which it is sold.*

*(2) The rule stated in Subsection (1) applies although*

- (a) the seller has exercised all possible care in the preparation and sale of his product, and*
- (b) the user or consumer has not bought the product from or entered into any contractual relation with the seller."*

5.12 The Uniform Commercial Code provides -

Section 2 - 302 - Unconscionable Contract or Clause

- "(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made, the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.*
- (2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable, the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination."*

5.13 Section 2 - 316 - Exclusion or Modification of Warranties

- "(1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this Article on parol or extrinsic evidence (section 2-202) negation or limitation is inoperative to the extent that such construction is unreasonable.*
- (2) Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the*



*language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that 'There are no warranties which extend beyond the description on the face hereof'.*

(3) *Notwithstanding subsection (2)*

(a) *unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like 'as is', 'with all faults' or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty; and*

(b) *when the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him; and*

(c) *an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade.*

(4) *Remedies for breach of warranty can be limited in accordance with the provisions of this Article on liquidation or limitation of damages and on contractual modification or remedy".*

5.14 Section 2 - 318 - Third Party Beneficiaries of Warranties Express or Implied

*"A seller's warranty whether express or implied extends to any natural person if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person, by breach of the warranty. A seller may not exclude or limit the operation of this section".*

5.15 Section 2 - 719 - Contractual Modification or Limitation of Remedy

"(1) *Subject to the provisions of subsections (2) and (3) of this section and of the preceding section on liquidation and limitation of damages,*

- (a) *the agreement may provide for remedies in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts; and*
  - (b) *resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.*
- (2) *Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act.*
  - (3) *Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not".*

## **Australia**

5.16 The Australian Trade Practices Act 1974 as amended by the Trade Practices Amendment Act 1977 was also studied by the Commission. Section 52, as amended in 1977, provides -

- "(1) *A corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.*
- (2) *Nothing in the succeeding provisions of this Division shall be taken as limiting by implication the generality of subsection (1)."*

5.17 This legislation should be read in conjunction with state law, but the former should prevail in cases of conflict. The Australian Act has some similarities with the Unfair Contract Terms Act but places more emphasis on the consumer - non consumer aspect. Federal legislation is unsuitable as a model for Hong Kong because it is not expected to cover all contingencies.

5.18 In New South Wales, local legislation has gone very much further than the English legislation. Under the Contracts Review Act 1980 (NSW) the court has wide power to review any contractual provision and adjust it in the light of its fairness. Section 7(1) provides -

*"When the Court finds a contract or a provision of a contract to have been unjust in the circumstances relating to the contract at the time it was made, the Court may, if it considers it just to do so, and for the purpose of avoiding as far as practicable an unjust consequence/result",*

grant the following relief -

- (a) declare a contract void in whole or in part;
- (b) refuse to enforce the contract;
- (c) vary the terms of the contract; or
- (d) employ ancillary powers set out in the Schedule.

We consider that such sweeping powers would be unsuitable for Hong Kong in that they would result in an unacceptable degree of uncertainty in Hong Kong's law of contract.

## **Conclusion**

5.19 We consider that the English Unfair Contract Terms Act provides a suitable model for the following reasons -

- (a) the Act deals specifically with control of exemption clauses; and
- (b) the English legislative model would be consistent with the rest of Hong Kong contract law which is derived from English common law and English statutes already adopted in Hong Kong, such as the Sale of Goods Act and the Misrepresentation Act.

5.20 We consider that as Hong Kong has followed the English legislation so far (for we have implemented earlier reforms in our Sale of Goods Ordinance (Cap. 26) and Misrepresentation Ordinance (Cap. 284)), and as the decisions following Photo Production Ltd. v Securicor Transport Ltd seem to have deprived the common law of protective force, it is imperative that Hong Kong amend its law in the near future. We recommend accordingly that the relevant provisions of the Unfair Contract Terms Act 1977 should be adopted in Hong Kong with appropriate amendments.

5.21 We considered the title of the United Kingdom Act. We think that "Unfair Contract Terms" is somewhat misleading. The Act is not concerned with all terms that might be regarded as harsh and unconscionable but only with exemption clauses. Nor is the Act concerned only with the terms of a contract; it also deals with non-contractual notices that exclude or limit liability in tort. For these reasons we suggest that any equivalent legislation in Hong Kong should be given some such title as the "Control of Exemption Clauses Ordinance".

5.22 In recommending the adoption of the UK Act in Hong Kong, we do not wish to suggest that such legislation should be the limit of consumer protection. In our view the development of "consumer" legislation in Hong Kong lags some way behind the development of the law in this area in other Commonwealth jurisdictions. If pressure in the community to emulate these developments were to increase, any further changes should occur only step by step and only after a thorough evaluation of the options for reform at each stage. The legislation we propose now is unlikely to remain the final development on the subject.

## 6. An outline of the Unfair Contract Terms Act 1977

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6.1 The Unfair Contract Terms Act 1977 is concerned only with exemption clauses and, as we have pointed out at para. 5.21, its title is therefore somewhat misleading. Furthermore, the Act does not confine itself to exemption clauses in contracts but applies also to notices excluding liability for breach of a duty arising independently of contract, such as a notice in premises excluding liability for injury or loss negligently caused to a visitor.

6.2 If a contract term or notice falls within the scope of the Act, control is exercised in one of two ways :

- (a) the exclusion or limitation of liability clause has no effect at all; or
- (b) it is effective only if it is found by the court to be reasonable.

6.3 The Act is concerned, for the most part, with the exclusion or restriction of "business liability", that is liability for breach of obligations or duties arising either from things done in the course of a business or from the occupation of the business premises of the occupier. The Act does not cover the exclusion or restriction of liability arising in a purely private capacity because the use of exemption clauses in that context is neither widespread nor gives rise to concern. If two neighbours agree that one should repair the other's television or motor car, there seems to be no reason why they should not make such arrangements as they please about who should bear the risk that the work may be done carelessly or unskilfully. The supplier of the service will generally be doing a favour to a friend or neighbour. The relationship between them is essentially a social one, and the supplier of the service will normally have a strong incentive to protect the interests of the other party. "Business" is not defined in the Act but is stated to include a profession and the activities of a Government department or local or public authority, which suggests that a "business" need not be carried on with a view to profit.

6.4 Some of the areas of control are confined to cases where one party to the contract "deals as consumer" in relation to the other. In order that a party should have dealt as consumer, two conditions must be satisfied. First, he must neither have made the contract in the course of a business nor have held himself out as doing so. Second, the other party must make the contract in the course of a business. Among these areas of control there is one which requires a third condition to be satisfied : in the case of a contract under which the ownership or possession of goods passes, the goods must be of a type ordinarily supplied for private use or consumption.

6.5 It is apparent from paragraphs 6.3 and 6.4 that the phrase "in the course of a business" is essential to the meaning both of "business liability" and "deals as consumer". It is convenient at this point to say that we considered whether "in the course of a business" should be defined with the object of distinguishing more clearly those transactions that would attract the controls of the Act and those that would not. We considered the guidance provided by a decision of the High Court in England, Peter Symmons & Co. v Cook, citation in which it was held that, to be in the course of a business, the transaction "must form at the very least an integral part of the buyer's business or be necessarily incidental thereto." Nothing in the Act suggests that the phrase is to mean one thing when applied to "business liability" and another when applied to "deals as consumer". The guidance provided by that decision applies also to the business liability of the seller. We concluded that it would be undesirable to attempt a more specific definition of "in the course of a business" for two reasons. Firstly, a definition in one context would affect the other unless it were confined to that one, an exercise which would further complicate a piece of legislation already complex enough. Secondly, any definition would risk separating our law from the judicial interpretations that are developing the law in England.

6.6 The Act introduces a further area of control as between contracting parties where one of them deals on the other's written standard terms of business. It is important to note that this area of control is not limited to consumer transactions; it would apply equally to transactions between parties both of whom were acting in the course of their respective business. The expression "written standard terms of business" is not defined. Broadly speaking, standard form contracts are of two different types. One type is exemplified by forms which may be adopted in commercial transactions of a particular type or for dealings in a particular commodity. Such forms may be drawn up by representative bodies with the intention of taking into account the conflicting interests of the different parties and producing a document acceptable to all. The other type is the form produced by, or on behalf of, one of the parties to an intended transaction for incorporation into a number of contracts of that type without negotiation. Examples include a multitude of printed documents setting out conditions of various kinds, terms found in catalogues and price lists, and terms set out or referred to in quotations, notices and tickets. Although it is the second type of standard form contract that has attracted most criticism, both types have in common the fact that they were not drafted with any particular transaction between particular parties in mind and are often entered into without much, if any, thought being given to the wisdom of the standard terms in the individual circumstances. An essential feature of standard form contracts is the lack of negotiation that exists in most situations where they are used.

However, lack of negotiation, or of any opportunity for negotiation, is not the only distinguishing feature of standard form contracts. In many such contracts there may be negotiation as to some terms, such as quantity or price, with no opportunity to negotiate the terms that exclude or limit liability. Even an expressed willingness to discuss terms may not in practice mean that the terms are any the less proffered on a "take it or leave it" basis. We share the

view of the English and Scottish Law Commissions that courts are well able to recognise standard terms used in the course of business and that it is undesirable to attempt a statutory description of a standard form contract.

6.7 Some or all of the provisions of the Act do not apply to contracts of the types specified in the Act. These exceptions are set out and considered in the following chapter of this report.

6.8 Having described broadly the areas of control, we turn now to describe in outline the kinds of exemption terms and notices that are made the subject of control. They fall into three broad categories. Firstly, there are those terms and notices which exclude or restrict liability for negligence, that is breach of the contractual duty to take reasonable care or exercise reasonable skill in the performance of a contract, or breach of the duty to take reasonable care or exercise reasonable skill at common law, or breach of the common law duty of care imposed on occupiers of premises towards their visitors. In the second category are those contractual terms which exclude or restrict liability for breach of certain terms implied by statute or common law in contracts for the supply of goods. Thirdly, there are those contractual terms which exclude or restrict liability for breach of contract or which purport to entitle one of the parties to render a contractual performance substantially different from that reasonably expected of him or to render no performance at all.

6.9 The expression "exclude or restrict liability" is given an extended meaning. A term or notice excludes or restricts liability if it :

- (a) makes the liability or its enforcement subject to restrictive or onerous conditions (for example, a term requiring one party to make a claim within a certain time-limit or to commence proceedings within a shorter time-limit than the normal limitation period);
  - (b) excludes or restricts any right or remedy in respect of the liability, or subject any person to any prejudice in consequence of his pursuing any such right or remedy (for example, a term which takes away or limits a buyer's right to reject defective goods, or requires him to pay the expenses of returning the goods on rejection);
- and (c) excludes or restricts the rules of evidence or procedure (for example, a term that acceptance of goods or services shall be conclusive evidence that they conform with the contract).

6.10 The Act specifically provides that an agreement in writing to submit disputes to arbitration is not to be treated as excluding or restricting any liability. This provision is discussed in chapter 8 where our views and recommendations on arbitration clauses are set out.

6.11 As mentioned in para. 6.2, if a contract term or a notice is subject to the control of the Act, that control takes one of two forms : the exemption clause may be absolutely ineffective, or it may be effective only in so far as it is held by a court to satisfy the requirement of reasonableness. The Act does not forbid the use of exemption clauses. As a means of protecting the consumer, the effectiveness of the Act depends on the consumer's knowledge of his rights under the Act. The terms and notices that are made absolutely ineffective are the following :

- (a) the exclusion or restriction of liability for death or personal injury resulting from negligence;
- (b) the exclusion or restriction of liability contained in a 'guarantee' attached to consumer goods where loss or damage is caused by the negligence of the manufacturer or distributor and arises from the goods proving defective while in consumer use;
- (c) in any consumer contract under which the ownership or possession of goods passes, the exclusion or restriction of liability for breach of the terms that the goods will correspond with the description or sample or will be of merchantable quality or fit for any particular purpose.

All other terms or notices controlled by the Act are ineffective only if they are found to be unreasonable.



## 7. A review of criticisms of the Unfair Contract Terms Act

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7.1 The Unfair Contract Terms Act has been criticised in some quarters, both on points of drafting and on more fundamental questions of the rationale behind the Act. We examine in this Chapter some of these criticisms.

### Freedom of contract

7.2 One argument against the Act's approach is based on the notion that any interference with freedom of contract is to be discouraged. In answer it may be said that this 'freedom' is often illusory. Although a contract is said to be based on the intentions of the parties these intentions are usually judged objectively; a private person negotiating with a large and powerful company may find the "intentions" a court will ascribe to him bear little relation to the understanding he actually had of his contract. Inroads have had to be made into freedom of contract in a number of areas. For instance, landlord and tenant legislation, and such consumer legislation as exists, generally seeks to redress the balance in cases where the advantage would otherwise lie predominantly with one side. The degree of interference with freedom of contract which is thought desirable is as much a political decision as a legal one. We believe that there is a need to provide greater control of exemption clauses to redress the balance between the consumer and the supplier.

### Reasonableness as a basis

7.3 It is further argued by opponents of control of contract terms that contracts are based on agreement between the parties. The terms a contract contains have therefore been accepted by both sides and should not be questioned at a later stage. Proponents of the English legislation respond by pointing out that some agreements are not reasonable and that it may be desirable to interfere with the contract in such cases. It should be pointed out that the English Act is not all-embracing; exclusions from the ambit of the legislation are made in cases where a contract is specially negotiated i.e. not on one party's standard terms between two businesses, and negligence is not involved (S.3). If the case of Photo Production Ltd. v. Securicor Transport Ltd<sup>20</sup> had been decided after the introduction of the Act, the result would have been the same for the disputed contract term would not have been caught under its provisions.

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<sup>20</sup> See para. 3.21

## **Uncertainty of interpretation**

7.4 A guiding principal in contract law has hitherto been "certainty". Contracts form the bedrock of commerce, and commerce demands certainty as a necessary prerequisite of any transaction and any investment. The "contract" is written evidence of an intention to create a legally binding duty. The contract states the intentions, the signatures assent to it, and the terms cannot be breached save on the payment of suitable damages. To superimpose on the legal duties defined in the contract a further condition that the terms themselves must be "reasonable" is, it is argued, to destroy this certainty. It is argued that the retroactively imposed test of reasonableness will mean that at the time of the drafting of the contract, the parties and their advisers will not know whether or not the terms agreed upon will meet with judicial approval.

7.5 The counter argument is that guidelines such as those included in the English legislation alleviate the problems. Further, the development of a body of judicial precedent will provide clear guidance to contracting parties. Finally, it is possible to frame the test of "reasonableness" to apply at the time of the signing of the contract not the time of its performance, breach or subsequent court action. The combination of these factors provide a degree of objectivity in a judgment which is, of necessity, retroactive.

7.6 It would be undesirable to argue that certainty should always prevail over justice, and misleading to argue that at present it does so throughout the law of contract. Judicial control often goes beyond mere construction and will, for instance, determine whether the object of the contract was unlawful or the contract itself misrepresented.

## **Judges as arbiters of reasonableness**

7.7 A further criticism of the Act's approach is that it is undesirable to have judges who are unfamiliar with business and commerce deciding disputes which arise in those areas. Apart from the fact that some judges do specialise in commercial cases, this criticism is usually based on a misunderstanding brought about by the title of the English Act. The judges are not, of course, asked to decide whether a contract is fair or unfair and then to renegotiate the contract, nor to decide on matters such as price and delivery date. They are merely asked to decide whether it is reasonable to try to escape a liability which would otherwise arise because of some failure in performance. In our system of law judges are frequently required to decide questions about which they have no direct practical experience. In a medical negligence action for example the judge is called upon to decide whether all reasonable care has been taken for the patient. He makes that decision in what may be a highly technical field of medicine in the light of the evidence and the arguments deployed before him. The Commission sees no difference in his function when considering the reasonableness or otherwise of a contractual term that purports to avoid or limit liability.

## The floodgates argument

7.8 Those who advance this argument foresee the danger of the courts being swamped with litigants seeking to test the reasonableness or otherwise of exemption clauses. It tends to be put forward whenever any reform of the law is proposed. To some extent too it may be based on a misunderstanding of the scope of the legislation.

7.9 In reply it should be pointed out that nothing of the kind has happened in the United Kingdom. If the argument is raised that there has not yet been sufficient time for the queues to develop, then it is helpful to note that the courts to some extent have closed the gates. The decision in George Mitchell (Chesterhall) Ltd v. Finnney Lock Seed Ltd<sup>21</sup> that higher courts will not unduly interfere with lower courts' decisions on negligence certainly reduces the likelihood of appeals.

7.10 The main counter argument is that the Act is concerned merely with exemption clauses and not with unfair contract terms in general. No doubt if Hong Kong were to follow the New South Wales pattern (see para. 5.18) this "floodgates argument" would have to be taken more seriously.

## The juristic basis

7.11 All the previous arguments are related. The argument as to juristic basis is separate, however, and on the face of it a serious criticism. The Act, say its critics, confines itself to cases where a person tries to shield himself against consequences of a liability which would otherwise arise because of a burden he has taken on himself. But suppose he never takes on the burden? Suppose the clause is seen simply as an allocation of the risk? This argument has not found favour with the courts and it is not universally accepted among academics. Certain liabilities clearly arise (as in sale of goods) and it would be difficult to argue that the seller was merely allocating the risk of unmerchantable goods to the buyer, rather than excluding his liability. On the other hand, it could be argued that a phrase such as "park at your own risk" might be seen as an allocation of liability. If it is, then the court would presumably be unable to apply the Act at all since this would not be an exemption clause.

7.12 We bore in mind the dissension among academics on this point but were not convinced by the criticism that the Act was based on false premises, and felt that the courts could deal with the practical problems which might arise.

7.13 To avoid possible difficulties, certain provisions of the Act could be redrafted as follows :-

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<sup>21</sup> [1983] 1 All E.R. 108

- (a) A subsection could be added to the anti-avoidance section (S.9) to the effect that the requirement of reasonableness is not avoided by drafting a clause as a statement of risk.
- (b) Section 13 (which defines the scope of the terms within the Act) could be redrafted to include "avoidance by use of definition of risk terms".

Nevertheless, we are not convinced that any such drafting is in fact necessary and we do not believe that arguments relating to the juristic basis of the legislation are convincing.

### **Criticism of drafting**

7.14 The Act has been criticised in some quarters as being obscure and complicated. The subject matter is complex, however, and it is not easy to suggest a way of simplifying the drafting without losing sight of the objectives. We do not think that complexity of drafting should of itself preclude the introduction of appropriate legislation in Hong Kong.

### **Conclusion**

7.15 We have carefully considered the criticisms which have been levelled against the Act and we are satisfied that the benefits of introducing to Hong Kong a measure of control similar to that imposed by the Unfair Contract Terms Act outweigh the difficulties which have been identified.

## 8. Our recommendations on the Unfair Contract Terms Act 1977

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8.1 We have outlined in Chapter 6 the main provisions of the Unfair Contract Terms 1977 and concluded that similar legislation should be introduced in Hong Kong. We now turn to a more detailed examination of the Act to identify the specific provisions which we recommend for adoption. The text of the Act itself is to be found at Annexure 5.

### Part I

#### *Section 1*

This section defines "negligence" to include breach of any common law duty of care and of any duty of care of an occupier as well as breach of an obligation to take care in the performance of a contract.

8.2 Section 1 also defines "business liability" as liability arising from things done in the course of one's own or another's business or from the occupation of business premises. With one minor exception, the Act only catches "business liability". Thus, contracts between private persons are not included. The section states that for the purposes of Part I, in relation to a breach of a duty or obligation, it does not matter whether the breach was intentional or not or whether liability arises directly or vicariously.

8.3 This section is partly definition, and partly information about the relationship between sections. It might have been better if these two functions had been separated. Nevertheless, we recommend that, subject to these considerations of drafting form, the content of Section 1 should be adopted in Hong Kong, in particular the scope of the provision to cover liability both in tort and in contract.

#### *Section 2*

8.4 Section 2 covers attempts to exclude or restrict liability for negligence by reference to a contract term or a notice. The effect of this section depends on the outcome of the negligence. Where death or personal injury has occurred an exclusion or limitation of liability cannot be relied on at all; where other loss or damage has occurred, then the reasonableness test in section 11 is applied. Section 2 also provides that awareness of a purported exemption clause does not indicate acceptance of the risk. Thus it is not possible to evade the section by pleading that a person has voluntarily accepted the risk of harm simply because he agreed to or was aware of the term or notice that purports to exclude or restrict liability.

8.5 This section, taken with the last, would cover such businesses as car parks or laundries which often seek to limit their liability for any loss. The section probably also applies to professional people such as surgeons and dentists (who have a common law duty of care) and manufacturers of goods, although it must not be forgotten that the duty has to arise in the course of a business.

8.6 We believe that the absolute prohibition on exclusion by a notice or contract term of liability for death or personal injury resulting from negligence should be adopted and that exclusion of liability for other loss should be subject to a test of reasonableness.

### **Section 3**

8.7 Section 3 is of limited application. Like sections 2 to 7, it applies only to business liability, but it has certain prerequisites for the section to apply at all. These are that one party must be a consumer or, if not, must contract on the written standard terms of business of the other. "Written standard terms of business" are not defined, and it will be for the court to decide exactly how much alteration to the standard terms would render them non-standard. All contracts made between two businesses on specially negotiated terms are therefore excluded from this section.

8.8 Section 3 prevents a businessman who contracts with a consumer or who contracts on his own written standard terms from

- (a) excluding or limiting his liability for breach of contract; or
- (b) from rendering a performance "substantially different from that which was reasonably expected of him"; or
- (c) from rendering no performance at all.

except insofar as the section 11 test of reasonableness is satisfied.

8.9 As we have already indicated (at para. 2.14, exemption clauses are sometimes imposed by a stronger party to a contract, leaving the weaker party little real option but to accept the contract complete with exemption clause or reject the contract entirely. It seems reasonable to suppose that such circumstances are most likely to arise where the parties to the contract are supplier and consumer. Section 3 recognises this fact and seeks to provide protection for the consumer who might otherwise be seriously disadvantaged in his contractual dealings.

8.10 We accept the reasoning inherent in this section and recommend that where one party deals as consumer or on written standard terms of business, any exclusion clause in respect of liability arising in contract should be subject to the test of reasonableness.

## **Section 4**

8.11 The section provides that where a person, dealing as consumer, agrees to indemnify another (who is acting in the course of business) that indemnification will be subject to the test of reasonableness. For example, where a person hands over his car to an employee of a car park the contract may require the consumer to indemnify the employer against any possible damage caused while the consumer's car is being driven by the employee. Such contract terms are subjected to the section 11 reasonableness test. We consider that this restraint on indemnity is sensible and should be adopted in Hong Kong. It is proper that the burden of proving the reasonableness of the indemnity clause should fall upon the party seeking to rely upon it.

## **Section 5**

8.12 The section applies to guarantees other than those given by the seller of goods. It refers to loss or damage arising from defective goods "while in consumer use" as a result of the negligence of the manufacturer or distributor. "In consumer use" is defined widely as use other than exclusively for the purposes of a business. It should be noted that this section applies to every kind of loss or damage and is not limited to death or personal injury. The section does not apply as between parties to a contract under which possession or ownership passes, since such contracts are adequately covered by sections 6 and 7.

8.13 We think it right that manufacturers or distributors should be precluded from restricting their liability for negligence and we recommend the adoption of a provision similar to section 5 in Hong Kong.

## **Section 6**

8.14 This section applies to liability arising under the implied terms contained in the Sale of Goods Act 1979 (the reference to the Sale of Goods Act 1893 in the Unfair Contract Terms Act when first enacted was subsequently amended when the 1979 consolidating statute came into force), in relation to sales of goods, and, under the Supply of Goods (Implied Terms) Act 1973 in relation to hire purchase.

8.15 Liability for breach of the implied undertakings as to title cannot be excluded or restricted in any contract. Whether other implied terms (as to description, quality and fitness) can be excluded depends on the nature of the purchaser. If the purchaser is a consumer such terms cannot be excluded at all. As against a non-consumer, the section 11 "reasonableness" test is applied to attempts at exclusion.

8.16 Sub-section (4) applies the section to all liabilities arising under contracts of sale or hire purchase, not merely those arising out of the course of a business as would otherwise be the case by virtue of the provision of section 1(3). There is no implied term as to quality and fitness in private contracts, but the remaining terms are implied in all contracts and section 6 will therefore have effect.

8.17 There is no legislation in Hong Kong corresponding to the Supply of Goods (Implied Terms) Act and so terms are implied into hire-purchase contracts by virtue of the common law rather than by statute. Subject to an amendment to recognise this fact and to the replacement of the Sale of Goods Act by the Sale of Goods Ordinance, we recommend that the provisions of section 6 be included in Hong Kong's legislation.

### **Section 7**

8.18 This section originally made similar provision to as section 6 for contracts other than sale of goods or hire purchase where ownership or possession of goods changed hands. As with section 6, there is a distinction drawn between consumer and non-consumer contracts. Where one party deals as consumer certain terms implied at common law cannot be excluded at all. In other cases, they can only be excluded if it is reasonable to do so. In contrast to section 6, however, exclusion of liability in respect of title is made subject to the reasonableness test, rather than prohibited altogether as it is under section 6.

8.19 Although the Act has been amended in England we have printed the original version at Annexure 5. Amendment was necessary to take account of the Supply of Goods and Services Act 1982 which gave statutory form to implied terms in contracts where goods changed hands. Implied terms as to title in contracts covered by the 1982 Act cannot be excluded but those falling under section 7(4) of the Unfair Contract Terms Act remain subject to a test of reasonableness.

8.20 The differences of approach adopted in sections 6 and 7 find their origin in paragraph 30 of the Law Commissions' Second Report on Exemption Clauses. The Commissions pointed out that the effect of section 12(3) of the Sale of Goods Act 1893 was to allow the parties to a contract to avoid the strict imposition of the implied terms as to title where the intention was to transfer only a limited title. The example is given of the receiver appointed over the affairs of a hire purchase company who may find that there is some doubt as to the company's title to a number of lorries it has repossessed from the hirers. If he wishes to let the lorries on hire, he cannot give the hirer an absolute undertaking as to title. The Commissions considered that such problems would be met by the introduction of a reasonableness test.

8.21 Section 7 applies to such areas as contracts for work and materials, contracts of barter, and hire contracts. It might be construed as



applying to repair contracts if the goods can be seen to change hands since section 7 simply refers to possession or ownership. The reference to possession is presumably intended to cover hire for in hire, possession, but not ownership, passes. It may be that a bailee such as a warehouseman could be said to be in possession under section 7. However, the section was designed to catch contracts with a family resemblance to section 6 and it is hard to see what application it would have to warehousing. If an object is returned repaired with new parts, those new parts could certainly come under section 7, and goods installed (such as radiators) would do so where the essence of the contract is not sale but work performed.

8.22 The proviso contained in section 7(5) regarding trading stamps is irrelevant to Hong Kong. Subject to deletion of that we recommend the adoption of the section 7 provisions.

## **Section 8**

8.23 This section substitutes a new section 3 in the Misrepresentation Act 1967. In effect, it clarifies that earlier attempt at a reasonableness requirement and imposes the reasonableness test in the Unfair Contract Terms Act. Section 3 of the Misrepresentation Act is equivalent to section 4 of Hong Kong's Misrepresentation Ordinance (Cap. 284).

8.24 Making section 4 of Cap. 284 part of a wider scheme of control should make it more comprehensible. It has been argued that it might be possible to avoid the effect of the section by a notice stating that no statement is to be relied upon as a representation. The courts have repeatedly refused to be impressed by this approach and have treated such statements as exemption clauses and applied the reasonableness test to them. The argument was put forward in Cremdean Properties Ltd. v Nash<sup>22</sup> and roundly rejected. In that case, the defendants sought to rely on a footnote in the following terms :- "These particulars are prepared for the convenience of an intending purchaser or tenant and although they are believed to be correct their accuracy is not guaranteed and any error, omission or misdescription shall not annul the sale or be grounds on which compensation may be claimed and neither do they constitute any part of an offer of a contract ... Any intending purchaser or tenant must satisfy himself by inspection or otherwise as to the correctness of each of the statements contained in these particulars".

8.25 The defendant contended that this footnote was effective to nullify any representation in the document altogether and brought about a situation as if no representation had been made at all. In rejecting this argument, Bridge L.J. said :

*"... the language of the footnote relied upon by [the defendant] simply does not, on its true interpretation, have the effect contended for. But I would go further and say that if the*

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(1977) 244 E.G. 547

*ingenuity of a draftsman could devise language which would have that effect, I am entirely doubtful whether the court would allow it to operate so as to defeat section 3 [of the Misrepresentation Act 1967]. Supposing the vendor included a clause which the purchase was required to, and did, agree to in some such terms as 'notwithstanding any statement of fact included in these particulars the vendor shall be conclusively deemed to have made no representation within the meaning of the Misrepresentation Act 1967', I should have thought that that was only a form of words the intended and actual effect of which was to exclude or restrict liability, and I should not have thought that the courts would have been ready to allow such ingenuity in forms of language to defeat the plain purpose at which section 3 is aimed" (at page 551).*

8.26 The modification of the reasonableness requirement of the Misrepresentation Act 1967 is in line with the tenor of the Unfair Contract Terms Act 1977. As such, we recommend that this provision be introduced to Hong Kong, amending section 4 of the Misrepresentation Ordinance.

### **Section 9**

8.27 This clause is designed to nullify the effect of Harbutts "Plasticine" Ltd. v Wayne Tank & Pump Co. Ltd.<sup>23</sup>. In that case it was held that an exemption clause could never be relied upon by a party in breach if as a result of his breach the contract was terminated. Even though the House of Lords in Photo Production Ltd. v Securicor Transport Ltd.<sup>24</sup> declared the former case to be wrongly decided, we recommend that section 9 should be retained for clarity. The section empowers the court to impose the test of reasonableness even though the contract has been terminated either by breach or by one party electing to repudiate. Similarly, the requirement of reasonableness is not excluded where a party affirms the contract after a breach. Since an exemption clause may be perfectly reasonable, notwithstanding the termination of the contract, we consider the approach adopted in Harbutts case to be indefensible.

### **Section 10**

8.28 This is an anti-avoidance provision. The section prevents the use of a second contract to prejudice the rights given by this legislation in respect of a first contract and we recommend its inclusion in Hong Kong's legislation.

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<sup>23</sup> [1970] 1 Q.B. 447

<sup>24</sup> See para. 3.19

## Section 11

8.29 This section sets out the reasonableness test. This test refers 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." In deciding whether the term was a fair and reasonable one, matters arising after making the contract cannot therefore be taken into account. It should be noted that the burden of proof lies on the party relying on the clause to prove that it is reasonable.

8.30 The English courts do not appear to have had any difficulty in operating the reasonableness test. In George Mitchell (Chesterhall) Ltd. v Finney Lock Seeds Ltd.<sup>25</sup> for example, the House of Lords decided that findings of reasonableness by a lower court should not be upset by an appellate court merely because of a difference of opinion on reasonableness. Lord Bridge remarked (at page 743) that "when asked to review such a decision on appeal, the appellate court should treat the original decision with the utmost respect and refrain from interference with it unless satisfied that it proceeded on some erroneous principle or was plainly and obviously wrong."

8.31 The test is not whether the term is reasonable in general, but whether it is reasonable as between the particular parties. In Southwestern General Property Co. v Josef Mardon<sup>26</sup> it was said that it was irrelevant that a term might have been fair as against a professional buyer when the buyer was an individual.

8.32 Where the action arises under sections 6 and 7 (i.e. in relation to contracts for the supply of goods) regard must be had to a list of factors in Schedule 2. Guideline (c) states that "whether or not the customer know or ought reasonably to have known of the existence and extent of the term" is relevant when determining the reasonableness of a clause. Additional considerations must be taken into account where the clause limits liability to a specified sum of money. Where there is a notice without contractual effect, reasonableness is tested at the time when liability would, but for the notice, have arisen.

8.33 We consider that the test imposed by section 11 is a fair one and we accordingly recommend that the reasonableness of a contract term excluding liability should be determined 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. In the context of Hong Kong, however, we consider that one factor must in all cases be taken into account when determining the reasonableness of an exemption clause, namely the language of the contract. Given that the overwhelming majority of the population is non-English speaking, the language in which the clause is expressed is necessarily a matter of some importance. Guideline (c) in Schedule 2 may indirectly lead a court to consider the language of the contract, but this guideline only applies in limited circumstances. We

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<sup>25</sup> [1983] 2 All E.R. 737

<sup>26</sup> Unreported - Full text of case in Lawson on 'Exclusion Clauses' 2nd Edition, Page 168

recommend that the language in which the contract is made should always be a factor to which the Court is specifically directed to have regard.

## **Section 12**

8.34 The section defines "deals as consumer". Under the 1977 Act to deal as consumer the individual must not only not deal in the course of a business, but he must not hold himself out as so doing. Thus, a private person who pretended to be "in the trade" to take advantage of a discount could not subsequently claim to be protected as a consumer. Section 12 further stipulates that the goods in question must be of a type usually supplied for consumer use, and the seller must act in the course of a business. Those who buy at auction or by tender are specifically excluded from being treated as dealing as consumers. The burden of proof lies on the party claiming that the other does not deal as consumer.

8.35 We consider the approach of the UK Act satisfactory and recommend that the definition of "deals as consumer" should be introduced to our legislation.

## **Section 13**

8.36 This section points out that 'exemption' includes any restriction. It will cover restrictive conditions such as time limits on seeking remedies, and reversal of the burden of proof whether set out in the Act or the normal rules of evidence. There is, however, a saving for arbitration clauses. Subsection (2) provides that an agreement in writing to submit disputes to arbitration is not to be treated as excluding or restricting any liability. We considered the legislative background of this provision.

8.37 In the United Kingdom, Parliament felt it was undesirable for a party in dispute to have to go to court in order to discover whether he was bringing his proceedings in the right forum. If the clause were held to be reasonable, he would have to start again before an arbitrator.

8.38 The House of Lords devised a different solution. It proposed that, as against a person dealing as consumer, an arbitration agreement should be unenforceable unless he consented to arbitration after a dispute had arisen or he had himself had recourse to arbitration in pursuance of the agreement. Such a provision would not apply to non domestic arbitration agreements nor to any contract to which the 1977 Act did not apply.

8.39 The Commons did not proceed to a vote on the proposed amendment. Those speaking against the proposal had the following points to make :

- (i) It goes well beyond the notion that the concept of caveat emptor is an inadequate safeguard to the consumer in today's complex society.
- (ii) It threatens the very concept of contract itself, the fundamental principle of which is that a bargain made should be a bargain kept. The proposal would allow the consumer to break an agreement he had made whenever it suited him to do so.
- (iii) Arbitration is a good thing and its use should be encouraged. The proposal would be a retrograde step. The trend in UK and in Europe is towards the settlement of disputes by arbitration. By a side wind, the trend would be reversed in certain contracts.
- (iv) Arbitration clauses are generally beneficial to the consumer (informality, speed, cheapness). The proposal would deprive an arbitration clause of validity until after a dispute had arisen. A supplier might just as well not have the clause in the contract at all. That would not be to the consumer's advantage but to his disadvantage.

8.40 In support of the proposal the following points were made:-

- (a) The consumer is given the choice.
- (b) He is given the choice not at the time that he buys the goods or services (at which time a dispute is far from his thoughts, he had little or no idea what arbitration involves and is not disposed to find out, so that in reality his choice is no choice at all), but when the dispute has arisen and his mind is focussed on the problem.
- (c) The proposal would not interfere with the process of arbitration, nor make arbitration more difficult to administer or less available.
- (d) The proposal would prevent arbitration being forced on the consumer when he would rather go to court.
- (e) The consumers' fundamental right to go to court should not be taken away by a discreet clause in a contract. It would be taken away because the courts regard it as a matter of public policy to uphold agreements to arbitrate.
- (f) A small claims tribunal may be more conveniently situated for the consumer and has staff available to help with drafting the claim. Legal aid may be available. By contrast, arbitration may have to be held at a place to suit the supplier not the consumer, no assistance is available to the consumer in drafting his claim and he would not be entitled to legal aid.

- (g) The consumer has to accept terms of arbitration laid down for him by the trader's organisation.
- (h) The 1977 Act is concerned with small print terms dealing with future liability for negligence and breach of contract. One such small print term is that future disputes will be referred to arbitration. It would therefore be relevant for any such Act to deal with the term that forces upon a consumer arbitration for settlement of future disputes.
- (i) Small Claims procedures and even ordinary court proceedings can be cheaper than arbitration. If arbitration is more convenient and cheaper in a particular case, the consumer can choose that course.
- (j) The Director of Fair Trading in UK negotiated a code of conduct with the Association of British Travel Agents that offers arbitration to the consumer only after the dispute has arisen.

8.41 We considered the following options :

- (i) Follow the 1977 Act and exclude arbitration clauses.
- (ii) For consumer transactions only, adopt the proposal advanced but rejected in Parliament, namely that an arbitration clause should be enforceable only if the consumer -
  - (a) agrees to arbitrate after the dispute has arisen, or
  - (b) has himself resorted to arbitration to settle the dispute. The proposal to apply only to "domestic" arbitrations and those contracts not otherwise excluded under the 1977 Act.
- (iii) Make arbitration clauses enforceable only if they pass the reasonableness test. Additionally, only if they relate to consumer transactions.
- (iv) Make arbitration clauses enforceable only if they do not occur in standard form contracts. Additionally, only if they do not apply to consumer transactions.
- (v) In consumer transactions (and standard form contracts), make arbitration clauses enforceable only if the consumer (or the other party to the standard form contract) has had the clause drawn to his attention and its effect explained to him in his own language and has specifically agreed to it at the time that he made the contract.

- (vi) Make no reference to arbitration clauses in any Bill like the 1977 Act and allow its provisions to bite with the result that an arbitration clause would be ineffective in some circumstances and effective in other circumstances only if reasonable.

8.42 We concluded that the best option was to allow arbitration clauses in consumer transactions to be enforceable if the consumer either agreed to arbitrate after a dispute had arisen or had himself resorted to arbitration to settle the dispute. We recommend therefore that option (ii) set out above should be adopted in Hong Kong.

### **Section 14**

8.43 This section contains definitions. These are self-evident, but may not be entirely appropriate to Hong Kong. It will be necessary, for instance, to change the definition of "hire-purchase agreement" and the definition of "business" might well be re-considered as regards the inclusion of the activities of government departments and local or public authorities. Subject to that, we recommend adoption of the definitions contained in section 14.

### **PART II - Sections 15 to 25**

8.44 Sections 15-25 apply similar provision to Scotland. Scots contract law is very different from English and it is English law rather than Scots which provides much of the basis for Hong Kong's contract law. It is therefore inappropriate to consider these sections further.

### **PART III - Sections 26-29**

8.45 Sections 26-29 ensure that the provisions of the Act are consistent with international law and other English legislation. Insofar as they are relevant and applicable in the light of Hong Kong's own international and domestic situation, they should be adopted in their entirety. In particular, we recommend the adoption of section 26 of the Act relating to international supply contracts. We further recommend that a choice of law clause provision similar to that in section 27 of the 1977 Act should be incorporated. In order to make temporary provision for sea carriage of passengers, we also recommend that the provisions of section 28 of the Act be adopted without modification.

8.46 However, we would draw attention to the fact that this last section provides for temporary incorporation of the provisions of the Athens Convention relating to the Carriage of Passengers and their Luggage by Sea 1974. The U.K. has signed this Convention, but the Convention is not yet in force. Pending the implementation of the Convention, this section makes interim arrangements for the U.K. concerning the application of the rules in

the Convention to certain contracts for the carriage of passengers and their luggage by sea. To what extent, if any, Hong Kong will be bound by the implementation or enactment of the Convention in the U.K. is a matter that will require investigation by the appropriate Government Departments with their counterparts in the U.K.

8.47 Section 29 provides a saving for other relevant legislation. A similar provision is recommended for Hong Kong (i.e. section 29(1), (2)(a) and (3)).

## **Schedule 1**

8.48 As pointed out in para. 8.1, the control of exemption provisions applies only to "business liability", that is liability for breach of obligations or duties arising either from things done or to be done by a person in the course of a business or from the occupation of premises used for business purposes of the occupier. Within those limits legislative control in general applies to all types of contract. There is however reason to make exception to that general rule in the case of particular types of contract. We examined the exceptions contained in Schedule 1 to the 1977 Act.

## **Contracts of insurance**

8.49 Although in the United Kingdom both the English and Scottish Law Commissions took the view that contracts of insurance should not be excluded from legislative control, Parliament was persuaded to exclude such contracts from the 1977 Act on the grounds that the insurance industry would otherwise be handicapped in international competition, that the level of premiums would rise if the controls were applied, that exclusion of liability clauses is usually no more than legitimate definition of the scope of the risk insured, and that anyway fair dealing by insurance companies is ensured by the industry's self-imposed code of conduct.

8.50 Insurers are entitled to refuse to indemnify the policy holder where he has failed to comply strictly with the terms of the policy. In Hong Kong, as elsewhere, insurers have sometimes made use of that right where the non-compliance by the policy holder bore little or no relation to the loss sustained by him. Two Hong Kong examples of such cases serve to make the point.

8.51 In Hang Seng Goldsmith Co v American International Assurance Co Ltd<sup>27</sup> the plaintiff was a goldsmith and jeweller. He claimed under a policy issued by the defendant, in respect of a robbery which caused the plaintiff a loss of more than \$1 million. The robbery took place when the shop was closed for business. The robbers accosted a partner of the plaintiff in the street and forced him to gain access to the shop in question. The defendant

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<sup>27</sup> (1985) HCt No. 8275 of 1983



was held not liable under the policy since the burglar alarms had not been switched on as required by the policy. The plaintiff's argument that the loss would still have occurred even if the alarms had been on was held to be irrelevant.

8.52 In Kwan On Furniture Co v Mutual Underwriters Ltd<sup>28</sup> the plaintiff claimed under a policy of marine insurance in respect of goods shipped from the East Coast of the United States to Hong Kong. On arrival, the goods were stored in a godown. When the plaintiffs went to collect the goods approximately two months later they were found to have been damaged before arrival. The defendants were held not to be liable on the basis that the plaintiffs had waited two months before inspecting the goods. This was held to be a breach of the policy requirement that the assured take such measures as might be reasonable to ensure that all rights against third parties were properly preserved and exercised.

8.53 An exclusion of liability clause can, of course, be used quite legitimately as a device for allocating contractual risks: by putting certain risks on one party, such a clause determines in advance who is to bear those risks; and it also enables a contracting party to quote different rates based on the services offered and the risks undertaken by him. Between businessmen bargaining at arm's length its use for these purposes is perfectly legitimate. As between parties of unequal bargaining power, however, an exemption clause can work unfairly and this is why we are recommending legislative controls.

8.54 We are not convinced that the grounds advanced in the United Kingdom are sufficient reason to exclude insurance contracts from legislative control in Hong Kong. Such control could be made to apply only to "domestic" insurance. A higher premium is a small price to pay for secure cover and is preferable to discovering after the event that the supposed cover has evaporated. The courts would have no difficulty in distinguishing the proper scope of the risk from an unreasonable exclusion of liability. There is as yet no industry code of conduct. Even if there were, it would not have the force of law. There is however one matter that persuaded us to refrain from recommending that insurance contracts should be subject to the control of the proposed exemption clauses legislation.

8.55 Our Insurance Report published in January 1986 recommends statutory provisions to regulate warranties and "basis of contract" clauses and the effects of non-disclosure and misrepresentation by the insured. In particular, clause 50E of the Insurance Companies (Amendment) Bill annexed to that report provides :-

*".... [where] there has been a failure by the policy holder to observe or perform a term of the policy, the court may, where it is satisfied that -*

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<sup>28</sup> (1977) VD Ct No. 2068 of 1977

- (a) *it is just and equitable in all the circumstances so to do;  
and*
- (b) *the insurer has not been materially prejudiced by the  
failure,*

*order that the failure be disregarded...."*

8.56 If that clause were enacted, we believe that regulation of insurance contracts under the proposed control of exemption clauses legislation would be duplicated to a large extent and would probably be unnecessary. We therefore recommend that, provided clause 50E is enacted, contracts of insurance should be excluded from the controls proposed in this report. If for any reason clause 50E were not to be enacted, we recommend that contracts of insurance should not be excluded from those controls.

8.57 We are concerned that the insured should be adequately protected from the sort of practices described in para 8.50. We recommend that, after the enactment of clause 50E, its effect on those practices should be monitored by the Insurance Authority. If clause 50E were to prove ineffective in eliminating those practices, we recommend that further consideration should be given to including contracts of insurance within the proposed statutory control of exemption clauses.

## **Contracts creating or transferring an interest in land**

8.58 While the English Law Commission saw no reason to exclude from control any category of contract, the Scottish Law Commission recommended that contracts relating to the creation of an interest in land should not be so subject.

8.59 Among the reasons advanced in support of the exclusion of such contracts, the most relevant to Hong Kong is the need for certainty and finality in land transactions. On the other hand, the strong demand for residential and office accommodation that has characterised the property business in Hong Kong in recent years has allowed the property developer to enjoy an overwhelming bargaining position over the purchaser, who has had little option but to accept whatever exemption of liability clauses the developer has seen fit to put into the contract.

8.60 In the 1977 Act the objective of certainty and finality has been balanced with the interests of the purchaser by excluding from the provisions of the Act only those parts of the contract that create or transfer the interest in the land. The exclusion is in the following terms :

*"Sections 2 to 4 of this Act do not extend to .... any contract so far as it relates to the creation or transfer of an interest in land, or to the termination of such an interest, whether by extinction,*

*merger, surrender, forfeiture or otherwise .... " (Emphasis supplied)*

In our view those words draw a distinction between the terms of the contract that create or transfer the interest in the land and the terms that do not. The former are excluded from the provisions of the Act, the latter are subject to the control of those provisions.

8.61 We believe that it is desirable to balance the interest of all property owners in Hong Kong in the continued certainty and finality of land transactions against the interest of the purchaser in protection from unreasonable exemption clauses.

8.62 We believe that that balance would be achieved by the adoption in Hong Kong of an exclusion similar to that contained in the 1977 Act. Accordingly we recommend the exclusion from the proposed legislation of any contract only so far as it relates to the creation or transfer of an interest in land, or to the termination of such an interest.

## **Other exclusions**

8.63 We considered each of the remaining exclusions in Schedule 1. With one exception, we recommend that each one of them should be adopted in Hong Kong. The exception is item 5 of the Schedule, which is concerned with discharges and indemnities relating to pneumoconiosis awards in the coal industry. We recommend that this exclusion should not form part of a Hong Kong Control of Exemption Clauses Ordinance.

## **Schedule 2**

8.64 As we have already indicated at para. 8.32, this contains guidelines for the reasonableness test. Similar guidelines are already to be found in relation to sale of goods at section 57(5) of the Sale of Goods Ordinance (Cap. 26). Our recommendation regarding the schedule 2 guidelines is at para. 8.33.

## **Schedule 3**

8.65 This schedule contains consequential amendments and repeals of UK legislation and as such is therefore not relevant to Hong Kong.

## **The Act and the common law**

8.66 The Act has not abolished the common law tests set out in Chapter 3. Where a term cannot be excluded by virtue of the Act (for instance,

in consumer sale of goods) it is obviously practical to use the Act as a first resort. However, in other cases, it may be appropriate to refer first to the common law. The retention of the common law rules may seem complicated but it serves to avoid the criticism that too much is left to the discretion of judges.

## Chapter 9

### Summary of recommendations

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9.1 We have concluded that the use of exemption clauses leads to abuse, especially where the parties are not in positions of equal bargaining strength, and we believe that the benefits of some measure of control outweigh any economic disadvantages which may be caused by this limited interference with the freedom of contract (para. 4.10).

9.2 We recommend that the relevant provisions of the UK Unfair Contract Terms Act 1977 should be adopted in Hong Kong with appropriate amendments (para. 5.20).

9.3 We suggest that the equivalent legislation in Hong Kong should be given some such title as the "Control of Exemption Clauses ordinance" (para. 5.21).

9.4 We recommend that Hong Kong's legislation should incorporate the following provisions of the UK Unfair Contract Terms Act 1977, subject to such amendment as may be necessary

- (i) Section 1 (para. 8.3);
- (ii) Section 2 (para. 8.6);
- (iii) Section 3 (para. 8.10);
- (iv) Section 4 (para. 8.11);
- (v) Section 5 (para. 8.13);
- (vi) Section 6 (para. 8.17);
- (vii) Section 7 (para. 8.22);
- (viii) Section 8 (para. 8.26);
- (ix) Section 9 (para. 8.27);
- (x) Section 10 (para. 8.28);
- (xi) Section 11 (para. 8.33);
- (xii) Section 12 (para. 8.35);

- (xiii) Section 14 (para. 8.43);
- (xiv) Section 26 (para. 8.45);
- (xv) Section 27 (para. 8.45);
- (xvi) Section 28 (para. 8.45);
- (xvii) Section 29 (para. 8.47);
- (xviii) Schedule 2, subject to the addition of an additional guideline that the language in which the contract is made should always be a factor to which the court is specifically directed to have regard. (para. 8.33).

9.5 We recommend that arbitration clauses in consumer contracts should be enforceable only if the consumer agrees to arbitrate after the dispute has arisen or has himself resorted to arbitration to settle the dispute. This should apply only to "domestic" arbitrations and those contracts not otherwise excluded under the 1977 Act (para. 8.42).

9.6 We recommend that, provided clause 50E of the Insurance Companies (Amendment) Bill annexed to our Insurance Report is enacted, contracts of insurance should be excluded for the controls proposed in this report. If clause 50E is not enacted, we recommend that contracts of insurance should not be excluded from those controls (para. 8.56).

9.7 If clause 50E were to prove ineffective in eliminating the particular practices at which it is aimed, we recommend that further consideration should be given to including contracts of insurance within the proposed statutory control of exemption clauses (para. 8.57).

9.8 We recommend the exclusion from the proposed legislation of any contract only so far as it relates to the creation or transfer of an interest in land, or to the termination of such an interest (para. 8.62).

9.9 Subject to paras. 9.6 to 9.8, we recommend that the exclusions contained in Schedule 1 of the UK Unfair Contract Terms Act 1977 should be adopted in Hong Kong, with the exception of item 5 (para. 8.63).

**MEMBERSHIP OF SUB-COMMITTEE**

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\* Up to March 1985

\*\* Up to 12 March 1984

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**Organisations, Firms and Individuals  
Invited to Comment or Who Volunteered Comment**

The Hong Kong Bar Association

The Law Society of Hong Kong

Hong Kong Society of Advocates

Federation of Women Lawyers

School of Law  
University of Hong Kong

Hong Kong Management Association

Consumer Council

Registrar, Supreme Court

Registrar General

Director of Legal Aid

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Chinese Manufacturers' Association of Hong Kong

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\*Firms and organisations which sent in responses to letter inviting comments

#Firms and individuals who were not circulated but commented on the subject

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ELIZABETH II



# Unfair Contract Terms Act 1977

1977 CHAPTER 50

An Act to impose further limits on the extent to which under the law of England and Wales and Northern Ireland civil liability for breach of contract, or for negligence or other breach of duty, can be avoided by means of contract terms and otherwise, and under the law of Scotland civil liability can be avoided by means of contract terms. [26th October 1977]

**B** E IT ENACTED by the Queen's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:—

## PART I

AMENDMENT OF LAW FOR ENGLAND AND WALES AND NORTHERN IRELAND

### *Introductory*

1. — (1) For the purposes of this Part of this Act, "negligence" means the breach—me Scope of Part I.

- (a) of any obligation, arising from the express or implied terms of a contract, to take reasonable care or exercise reasonable skill in the performance of the contract;
- (b) of any common law duty to take reasonable care or exercise reasonable skill (but not any stricter duty) ;

PART I  
1957 c. 31.  
1957 c. 25.  
(N.I.)

(c) of the common duty of care imposed by the Occupiers' Liability Act 1957 or the Occupiers' Liability Act (Northern Ireland) 1957.

(2) This Part of this Act is subject to Part III; and in relation to contracts, the operation of sections 2 to 4 and 7 is subject to the exceptions made by Schedule 1.

(3) In the case of both contract and tort, sections 2 to 7 apply (except where the contrary is stated in section 6(4)) only to business liability, that is liability for breach of obligations or duties arising—

- (a) from things done or to be done by a person in the course of a business (whether his own business or another's);  
or
- (b) from the occupation of premises used for business purposes of the occupier;

and references to liability are to be read accordingly.

(4) In relation to any breach of duty or obligation, it is immaterial for any purpose of this Part of this Act whether the breach was inadvertent or intentional, or whether liability for it arises directly or vicariously.

*Avoidance of liability for negligence breach of contract, etc.*

Negligence  
liability.

**2.** — (1) A person cannot by reference to any contract term or to a notice given to persons generally or to particular persons exclude or restrict his liability for death or personal injury resulting from negligence.

(2) In the case of other loss or damage, a person cannot so exclude or restrict his liability for negligence except in so far as the term or notice satisfies the requirement of reasonableness.

(3) Where a contract term or notice purports to exclude or restrict liability for negligence a person's agreement to or awareness of it is not of itself to be taken as indicating his voluntary acceptance of any risk.

Liability arising  
in contract.

**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
- (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,

PART I

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

**4.** — (1) A person dealing as consumer cannot by reference to any contract term be made to indemnify another person (whether a party to the contract or not) in respect of liability that may be incurred by the other for negligence or breach of contract, except in so far as the contract term satisfies the requirement of reasonableness.

Unreasonable indemnity clauses.

(2) This section applies whether the liability in question—

- (a) is directly that of the person to be indemnified or is incurred by him vicariously;
- (b) is to the person dealing as consumer or to someone else.

*Liability arising from sale or supply of goods*

**5.** — (1) In the case of goods of a type ordinarily supplied for private use or consumption, where loss or damage—

"Guarantee" of consumer goods.

- (a) arises from the goods proving defective while in consumer use ; and
- (b) results from the negligence of a person concerned in the manufacture or distribution of the goods,

liability for the loss or damage cannot be excluded or restricted by reference to any contract term or notice contained in or operating by reference to a guarantee of the goods.

(2) For these purposes—

- (a) goods are to be regarded as "in consumer use" when a person is using them, or has them in his possession for use, otherwise than exclusively for the purposes of a business ; and
- (b) anything in writing is a guarantee if it contains or purports to contain some promise or assurance (however worded or presented) that defects will be made good by complete or partial replacement, or by repair, monetary compensation or otherwise.

(3) This section does not apply as between the parties to a contract under or in pursuance of which possession or ownership of the goods passed.

**6.** — (1) Liability for breach of the obligations arising from—

Sale and hire-purchase. 56 & 57 Vict. c. 71.

- (a) section 12 of the Sale of Goods Act 1893 (seller's implied undertakings as to title, etc.);

**B**

PART I  
1973 c. 13.

- (b) section 8 of the Supply of Goods (Implied Terms) Act 1973 (the corresponding thing in relation to hire-purchase),

cannot be excluded or restricted by reference to any contract term.

(2) As against a person dealing as consumer, liability for breach of the obligations arising from—

- (a) section 13, 14 or 15 of the 1893 Act (seller's implied undertakings as to conformity of goods with description or sample, or as to their quality or fitness for a particular purpose);

- (b) section 9, 10 or 11 of the 1973 Act (the corresponding things in relation to hire-purchase).

cannot be excluded or restricted by reference to any contract term.

(3) As against a person dealing otherwise than as consumer, the liability specified in subsection (2) above can be excluded or restricted by reference to a contract term, but only in so far as the term satisfies the requirement of reasonableness.

(4) The liabilities referred to in this section are not only the business liabilities defined by section 1(3), but include those arising under any contract of sale of goods or hire-purchase agreement.

Miscellaneous  
contracts  
under which  
goods pass.

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 or fitness for any particular purpose, cannot be excluded or restricted by reference to any such 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 the goods, or give possession; or
- (b) the assurance of quiet possession to a person taking 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.

PART I

(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.

1964 c. 71.  
1965 c. 6.  
(N.I.).

*Other provisions about contracts*

8.—(1) In the Misrepresentation Act 1967, the following is substituted for section 3—

Misrepresentation.  
1967 c. 7.

"Avoidance of provision excluding liability for misrepresentation.

3. If a contract contains a term which would exclude or restrict—

(a) any liability to which a party to a contract may be subject by reason of any misrepresentation made by him before the contract was made; or

(b) any remedy available to another party to the contract by reason of such a misrepresentation,

that term shall be of no effect except in so far as it satisfies the requirement of reasonableness as stated in section 11(1) of the Unfair Contract Terms Act 1977 ; and it is for those claiming that the term satisfies that requirement to show that it does."

(2) The same section is substituted for section 3 of the Misrepresentation Act (Northern Ireland) 1967.

1967 c. 14  
(N.I.).

9.—(1) Where for reliance upon it a contract term has to satisfy the requirement of reasonableness, it may be found to do so and be given effect accordingly notwithstanding that the contract has been terminated either by breach or by a party electing to treat it as repudiated.

Effect of breach.

(2) Where on a breach the contract is nevertheless affirmed by a party entitled to treat it as repudiated, this does not of itself exclude the requirement of reasonableness in relation to any contract term.

10. A person is not bound by any contract term prejudicing or taking away rights of his which arise under, or in connection with the performance of, another contract, so far as those rights extend to the enforcement of another's liability which this Part of this Act prevents that other from excluding or restricting.

Evasion by means of secondary contract.

## PART I

*Explanatory provisions*

The "reason-  
ableness"  
test.  
1967 c. 7.  
1967 c. 14.  
(N.I.)

**11.—**(1) In relation to a contract term, the requirement of reasonableness for the purposes of this Part of this Act, section 3 of the Misrepresentation Act 1967 and section 3 of the Misrepresentation Act (Northern Ireland) 1967 is that the term shall have 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.

(2) In determining for the purposes of section 6 or 7 above whether a contract term satisfies the requirement of reasonableness, regard shall be had in particular to the matters specified in Schedule 2 to this Act; but this 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.

(3) In relation to a notice (not being a notice having contractual effect), the requirement of reasonableness under this Act is that it should be fair and reasonable to allow reliance on it, having regard to all the circumstances obtaining when the liability arose or (but for the notice) would have arisen.

(4) Where by reference to a contract term or notice a person seeks to restrict liability to a specified sum of money, and the question arises (under this or any other Act) whether the term or notice satisfies the requirement of reasonableness, regard shall be had in particular (but without prejudice to subsection (2) above in the case of contract terms) to—

(a) the resources which he could expect to be available to him for the purpose of meeting the liability should it arise; and

(b) how far it was open to him to cover himself by insurance.

(5) It is for those claiming that a contract term or notice satisfies the requirement of reasonableness to show that it does.

"Dealing as  
consumer"

**12. —** (1) A party to a contract "deals as consumer" in relation to another party if—

(a) he neither makes the contract in the course of a business nor holds himself out as doing so; and

(b) the other party does make the contract in the course of a business; and

(c) in the case of a contract governed by the law of sale of goods or hire-purchase, or by section 7 of this Act the goods passing under or in pursuance of the contract are of a type ordinarily supplied for private use or consumption.

PART I

(2) But on a sale by auction or by competitive tender the buyer is not in any circumstances to be regarded as dealing as consumer.

(3) Subject to this, it is for those claiming that a party does not deal as consumer to show that he does not.

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

Varieties of exemption clause.

(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.

14.—In this Part of this Act—

Interpretation of Part I.

"business" includes a profession and the activities of any government department or local or public authority;

"goods" has the same meaning as in the Sale of Goods Act 1893;

56 & 57 Vict. c. 71.

"hire-purchase agreement" has the same meaning as in the Consumer Credit Act 1974;

1974 c. 39.

"negligence" has the meaning given by section 1 (1);

"notice" includes an announcement, whether or not in writing, and any other communication or pretended communication; and

"personal injury" includes any disease and any impairment of physical or mental condition.

**PART II****AMENDMENT OF LAW FOR SCOTLAND**

Scope of  
Part II.

**15.**—(1) This Part of this Act applies only to contracts, is subject to Part III of this Act and does not affect the validity of any discharge or indemnity given by a person in consideration of the receipt by him of compensation in settlement of any claim which he has.

(2) Subject to subsection (3) below, sections 16 to 18 of this Act apply to any contract only to the extent that the contract—

- (a) relates to the transfer of the ownership or possession of goods from one person to another (with or without work having been done on them);
- (b) constitutes a contract of service or apprenticeship;
- (c) relates to services of whatever kind, including (without prejudice to the foregoing generality) carriage, deposit and pledge, care and custody, mandate, agency, loan and services relating to the use of land;
- (d) relates to the liability of an occupier of land to persons entering upon or using that land;
- (e) relates to a grant of any right or permission to enter upon or use land not amounting to an estate or interest in the land.

(3) Notwithstanding anything in subsection (2) above, sections 16 to 18—

- (a) do not apply to any contract to the extent that the contract—
  - (i) is a contract of insurance (including a contract to pay an annuity on human life);
  - (ii) relates to the formation constitution or dissolution of any body corporate or unincorporated association or partnership;

(b) apply to—

- a contract of marine salvage or towage;
- a charter party of a ship or hovercraft;
- a contract for the carriage of goods by ship or hovercraft; or,
- a contract to which subsection (4) below relates,

only to the extent that—

- (i) both parties deal or hold themselves out as dealing in the course of a business (and then only in so far as the contract purports to exclude or restrict liability for breach of duty in respect of death or personal injury); or
- (ii) the contract is a consumer contract (and then only in favour of the consumer).

(4) This subsection relates to a contract in pursuance of which goods are carried by ship or hovercraft and which either—

PART II

(a) specifies ship or hovercraft as the means of carriage over part of the journey to be covered; or

(b) makes no provision as to the means of carriage and does not exclude ship or hovercraft as that means,

in so far as the contract operates for and in relation to the carriage of the goods by that means.

**16.—**(1) Where a term of a contract purports to exclude or restrict liability for breach of duty arising in the course of any business or from the occupation of any premises used for business purposes of the occupier, that term—

Liability for breach of duty.

(a) shall be void in any case where such exclusion or restriction is in respect of death or personal injury;

(b) shall in any other case, have no effect if it was not fair and reasonable to incorporate the term in the contract.

(2) Subsection (1)(a) above does not affect the validity of any discharge and indemnity given by a person, on or in connection with an award to him of compensation for pneumoconiosis attributable to employment in the coal industry, in respect of any further claim arising from his contracting that disease.

(3) Where under subsection (1) above a term of a contract is void or has no effect, the fact that a person agreed to, or was aware of, the term shall not of itself be sufficient evidence that he knowingly and voluntarily assumed any risk.

**17.—**(1) Any term of a contract which is a consumer contract or a standard form contract shall have no effect for the purpose of enabling a party to the contract—

Control of unreasonable exemptions in consumer or standard form contracts.

(a) who is in breach of a contractual obligation, to exclude or restrict any liability of his to the consumer or customer in respect of the breach;

(b) in respect of a contractual obligation, to render no performance, or to render a performance substantially different from that which the consumer or customer reasonably expected from the contract;

if it was not fair and reasonable to incorporate the term in the contract.

(2) In this section "customer" means a party to a standard form contract who deals on the basis of written standard terms of business of the other party to the contract who himself deals in the course of a business.

PART II  
Unreasonable  
indemnity  
clauses in  
consumer  
contracts.

**18.** — (1) Any term of a contract which is a consumer contract shall have no effect for the purpose of making the consumer indemnify another person (whether a party to the contract or not) in respect of liability which that other person may incur as a result of breach of duty or breach of contract, if it was not fair and reasonable to incorporate the term in the contract.

(2) In this section "liability" means liability arising in the course of any business or from the occupation of any premises used for business purposes of the occupier.

"Guarantee"  
of consumer  
goods.

**19.** — This section applies to a guarantee—

(a) in relation to goods which are of a type ordinarily supplied for private use or consumption; and

(b) which is not a guarantee given by one party to the other party to a contract under or in pursuance of which the ownership or possession of the goods to which the guarantee relates is transferred.

(2) A term of a guarantee to which this section applies shall be void in so far as it purports to exclude or restrict liability for loss or damage (including death or personal injury)—

(a) arising from the goods proving defective while—

(i) in use otherwise than exclusively for the purposes of a business ; or

(ii) in the possession of a person for such use;  
and

(b) resulting from the breach of duty of a person concerned in the manufacture or distribution of the goods.

(3) For the purposes of this section, any document is a guarantee if it contains or purports to contain some promise or assurance (however worded or presented) that defects will be made good by complete or partial replacement, or by repair, monetary compensation or otherwise.

Obligations  
implied by law  
in sale and  
hire-purchase  
contracts. 56 &  
57 Vict. c. 71.  
1973 c. 13.

**20.**—(1) Any term of a contract which purports to exclude or restrict liability for breach of the obligations arising from—

(a) section 12 of the Sale of Goods Act 1893 (seller's implied undertakings as to title etc.);

(b) section 8 of the Supply of Goods (Implied Terms) Act 1973 (implied terms as to title in hire-purchase agreements),

shall be void.

(2) Any term of a contract which purports to exclude or restrict liability for breach of the obligations arising from—

- (a) section 13, 14 or 15 of the said Act of 1893 (seller's implied undertakings as to conformity of goods with description or sample, or as to their quality or fitness for a particular purpose);
- (b) section 9, 10 or 11 of the said Act of 1973 (the corresponding provisions in relation to hire-purchase),

shall—

- (i) in the case of a consumer contract, be void against the consumer;
- (ii) in any other case, have no effect if it was not fair and reasonable to incorporate the term in the contract.

**21.—**(1) Any term of a contract to which this section applies purporting to exclude or restrict liability for breach of an obligation—

Obligations implied by law in other contracts for the supply of goods.

- (a) such as is referred to in subsection (3)(a) below—
  - (i) in the case of a consumer contract, shall be void against the consumer, and
  - (ii) in any other case, shall have no effect if it was not fair and reasonable to incorporate the term in the contract;
- (b) such as is referred to in subsection (3)(b) below, shall have no effect if it was not fair and reasonable to incorporate the term in the contract.

(2) This section applies to any contract to the extent that it relates to any such matter as is referred to in section 15(2)(a) of this Act, but does not apply to—

- (a) a contract of sale of goods or a hire-purchase agreement; or
- (b) a charterparty of a ship or hovercraft unless it is a consumer contract (and then only in favour of the consumer).

(3) An obligation referred to in this subsection is an obligation incurred under a contract in the course of a business and arising by implication of law from the nature of the contract which relates—

- (a) to the correspondence of goods with description or sample, or to the quality or fitness of goods for any particular purpose; or
- (b) to any right to transfer ownership or possession of goods, or to the enjoyment of quiet possession of goods.

(4) Nothing in this section applies to the supply of goods on a redemption of trading stamps within the Trading Stamps Act 1964.

1964 c. 71.

PART II  
Consequence  
of breach.

**22.** For the avoidance of doubt, where any provision of this Part of this Act requires that the incorporation of a term in a contract must be fair and reasonable for that term to have effect—

(a) if that requirement is satisfied, the term may be given effect to notwithstanding that the contract has been terminated in consequence of breach of that contract;

(b) for the term to be given effect to, that requirement must be satisfied even where a party who is entitled to rescind the contract elects not to rescind it.

Evasion by  
means of  
secondary  
contract.

**23.** Any term of any contract shall be void which purports to exclude or restrict, or has the effect of excluding or restricting—

(a) the exercise, by a party to any other contract, of any right or remedy which arises in respect of that other contract in consequence of breach of duty, or of obligation, liability for which could not by virtue of the provisions of this Part of this Act be excluded or restricted by a term of that other contract;

(b) the application of the provisions of this Part of this Act in respect of that or any other contract.

The  
"reasonable-  
ness" test.

**24.—(1)** In determining for the purposes of this Part of this Act whether it was fair and reasonable to incorporate a term in a contract, regard shall be had only to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties to the contract at the time the contract was made.

(2) In determining for the purposes of section 20 or 21 of this Act whether it was fair and reasonable to incorporate a term in a contract, regard shall be had in particular to the matters specified in Schedule 2 to this Act; but this subsection shall not prevent a court or arbiter 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.

(3) Where a term in a contract purports to restrict liability to a specified sum of money, and the question arises for the purposes of this Part of this Act whether it was fair and reasonable to incorporate the term in the contract, then, without prejudice to subsection (2) above, regard shall be had in particular to—

(a) the resources which the party seeking to rely on that term could expect to be available to him for the purpose of meeting the liability should it arise;



(b) how far it was open to that party to cover himself by insurance.

PART II

(4) The onus of proving that it was fair and reasonable to incorporate a term in a contract shall lie on the party so contending.

25. — (1) In this Part of this Act—

Interpretation of Part II.

"breach of duty" means the breach—

(a) of any obligation, arising from the express or implied terms of a contract, to take reasonable care or exercise reasonable skill in the performance of the contract;

(b) of any common law duty to take reasonable care or exercise reasonable skill;

(c) of the duty of reasonable care imposed by section 2(1) of the Occupiers' Liability (Scotland) Act 1960;

1960 C. 30.

"business" includes a profession and the activities of any government department or local or public authority;

"consumer" has the meaning assigned to that expression in the definition in this section of "consumer contract";

"consumer contract" means a contract (not being a contract of sale by auction or competitive tender) in which—

(a) one party to the contract deals, and the other party to the contract ("the consumer") does not deal or hold himself out as dealing, in the course of a business, and

(b) in the case of a contract such as is mentioned in section 15(2)(a) of this Act, the goods are of a type ordinarily supplied for private use or consumption;

and for the purposes of this Part of this Act the onus of proving that a contract is not to be regarded as a consumer contract shall lie on the party so contending;

56 & 57  
Vict. c. 71.

"goods" has the same meaning as in the Sale of Goods Act 1893;

1974 c. 39.

"hire-purchase agreement" has the same meaning as in section 189(1) of the Consumer Credit Act 1974;

"personal injury" includes any disease and any impairment of physical or mental condition.

(2) In relation to any breach of duty or obligation, it is immaterial for any purpose of this Part of this Act whether the act or omission giving rise to that breach was inadvertent or

## PART II

intentional, or whether liability for it arises directly or vicariously.

(3) In this Part of this Act, any reference to excluding or restricting any liability includes—

- (a) making the liability or its enforcement subject to any 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 any rule of evidence or procedure;
- (d) excluding or restricting any liability by reference to a notice having contractual effect,

but does not include an agreement to submit any question to arbitration.

(4) In subsection (3)(d) above "notice" includes an announcement, whether or not in writing, and any other communication or pretended communication.

(5) In sections 15 and 16 and 19 to 21 of this Act, any reference to excluding or restricting liability for breach of an obligation or duty shall include a reference to excluding or restricting the obligation or duty itself.

## PART III

## PROVISIONS APPLYING TO WHOLE OF UNITED KINGDOM

*Miscellaneous*

International  
supply  
contracts.

**26.**—(1) The limits imposed by this Act on the extent to which a person may exclude or restrict liability by reference to a contract term do not apply to liability arising under such a contract as is described in subsection (3) below.

(2) The terms of such a contract are not subject to any requirement of reasonableness under section 3 or 4: and nothing in Part II of this Act shall require the incorporation of the terms of such a contract to be fair and reasonable for them to have effect.

(3) Subject to subsection (4), that description of contract is one whose characteristics are the following—

- (a) either it is a contract of sale of goods or it is one under or in pursuance of which the possession or ownership of goods passes; and

(b) it is made by parties whose places of business (or, if they have none, habitual residences) are in the territories of different States (the Channel Islands and the Isle of Man being treated for this purpose as different States from the United Kingdom).

PART III

(4) A contract falls within subsection (3) above only if either—

(a) the goods in question are, at the time of the conclusion of the contract, in the course of carriage, or will be carried, from the territory of one State to the territory of another; or

(b) the acts constituting the offer and acceptance have been done in the territories of different States; or

(c) the contract provides for the goods to be delivered to the territory of a State other than that within whose territory those acts were done.

**27.**—(1) Where the proper law of a contract is the law of any part of the United Kingdom only by choice of the parties (and apart from that choice would be the law of some country outside the United Kingdom) sections 2 to 7 and 16 to 21 of this Act do not operate as part of the proper law.

Choice of law clauses.

(2) This Act has effect notwithstanding any contract term which applies or purports to apply the law of some country outside the United Kingdom, where (either or both)—

(a) the term appears to the court, or arbitrator or arbiter to have been imposed wholly or mainly for the purpose of enabling the party imposing it to evade the operation of this Act; or

(b) in the making of the contract one of the parties dealt as consumer, and he was then habitually resident in the United Kingdom, and the essential steps necessary for the making of the contract were taken there, whether by him or by others on his behalf.

(3) In the application of subsection (2) above to Scotland, for paragraph (b) there shall be substituted—

"(b) the contract is a consumer contract as defined in Part II of this Act, and the consumer at the date when the contract was made was habitually resident in the United Kingdom, and the essential steps necessary for the making of the contract were taken there, whether by him or by others on his behalf."

**28.** — (1) This section applies to a contract for carriage by sea of a passenger or of a passenger and his luggage where the provisions of the Athens Convention (with or without modification) do not have, in relation to the contract, the force of law in the United Kingdom.

Temporary provision for sea carriage of passengers.

## PART III

(2) In a case where—

- (a) the contract is not made in the United Kingdom, and
- (b) neither the place of departure nor the place of destination under it is in the United Kingdom.

a person is not precluded by this Act from excluding or restricting liability for loss or damage, being loss or damage for which the provisions of the Convention would, if they had the force of law in relation to the contract, impose liability on him.

(3) In any other case, a person is not precluded by this Act from excluding or restricting liability for that loss or damage—

- (a) in so far as the exclusion or restriction would have been effective in that case had the provisions of the Convention had the force of law in relation to the contract; or
- (b) in such circumstances and to such extent as may be prescribed, by reference to a prescribed term of the contract.

(4) For the purposes of subsection (3)(a), the values which shall be taken to be the official values in the United Kingdom of the amounts (expressed in gold francs) by reference to which liability under the provisions of the Convention is limited shall be such amounts in sterling as the Secretary of State may from time to time by order made by statutory instrument specify.

(5) In this section, —

- (a) the references to excluding or restricting liability include doing any of those things in relation to the liability which are mentioned in section 13 or section 25(3) and (5); and
- (b) "the Athens Convention" means the Athens Convention relating to the Carriage of Passengers and their Luggage by Sea, 1974; and
- (c) "prescribed" means prescribed by the Secretary of State by regulations made by statutory instrument;

and a statutory instrument containing the regulations shall be subject to annulment in pursuance of a resolution of either House of Parliament.

Saying for other relevant legislation.

**29.—**(1) Nothing in this Act removes or restricts the effect of, or prevents reliance upon, any contractual provision which—

- (a) is authorised or required by the express terms or necessary implication of an enactment; or

(b) being made with a view to compliance with an international agreement to which the United Kingdom is a party, does not operate more restrictively than is contemplated by the agreement. PART III

(2) A contract term is to be taken—

(a) for the purposes of Part I of this Act, as satisfying the requirement of reasonableness; and

(b) for those of Part II, to have been fair and reasonable to incorporate,

if it is incorporated or approved by, or incorporated pursuant to a decision or ruling of, a competent authority acting in the exercise of any statutory jurisdiction or function and is not a term in a contract to which the competent authority is itself a party.

(3) In this section—

"competent authority" means any court, arbitrator or arbiter, government department or public authority;

"enactment" means any legislation (including subordinate legislation) of the United Kingdom or Northern Ireland and any instrument having effect by virtue of such legislation; and

"statutory" means conferred by an enactment.

**30.**—(1) In section 3 of the Consumer Protection Act 1961 (provisions against marketing goods which do not comply with safety requirements), after subsection (1) there is inserted— Obligations under Consumer Protection Acts. 1961 c. 40.

"(1A) Any term of an agreement which purports to exclude or restrict, or has the effect of excluding or restricting, any obligation imposed by or by virtue of that section, or any liability for breach of such an obligation, shall be void."

(2) The same amendment is made in section 3 of the Consumer Protection Act (Northern Ireland) 1965. 1965 c. 14 (N.I.).

*General*

31—(1) This Act comes into force on 1st February 1978. Commencement; amendments; repeals.

(2) Nothing in this Act applies to contracts made before the date on which it comes into force; but subject to this, it applies to liability for any loss or damage which is suffered on or after that date.

(3) The enactments specified in Schedule 3 to this Act are amended as there shown.

(4) The enactments specified in Schedule 4 to this Act are repealed to the extent specified in column 3 of that Schedule.

PART III  
Citation and  
extent.

32—(1) This Act may be cited as the Unfair Contract Terms Act 1977.

(2) Part I of this Act extends to England and Wales and to Northern Ireland; but it does not extend to Scotland.

(3) Part II of this Act extends to Scotland only.

(4) This Part of this Act extends to the whole of the United Kingdom.

## SCHEDULES

### SCHEDULE 1

Section 1(2).

#### SCOPE OF SECTIONS 2 TO 4 AND 7

1. Sections 2 to 4 of this Act do not extend to—

- (a) any contract of insurance (including a contract to pay an annuity on human life);
- (b) any contract so far as it relates to the creation or transfer of an interest in land, or to the termination of such an interest, whether by extinction, merger, surrender, forfeiture or otherwise.
- (c) any contract so far as it relates to the creation or transfer of a right or interest in any patent, trade mark, copyright, registered design, technical or commercial information or other intellectual property, or relates to the termination of any such right or interest;
- (d) any contract so far as it relates—
  - (i) to the formation or dissolution of a company (which means any body corporate or unincorporated association and includes a partnership), or
  - (ii) to its constitution or the rights or obligations of its corporators or members;
- (e) any contract so far as it relates to the creation or transfer of securities or of any right or interest in securities.

2. Section 2(1) extends to—

- (a) any contract of marine salvage or towage;
- (b) any charterparty of a ship or hovercraft; and
- (c) any contract for the carriage of goods by ship or hovercraft;

but subject to this sections 2 to 4 and 7 do not extend to any such contract except in favour of a person dealing as consumer.

3. Where goods are carried by ship or hovercraft in pursuance of a contract which either—

- (a) specifies that as the means of carriage over part of the journey to be covered, or
- (b) makes no provision as to the means of carriage and does not exclude that means,

then sections 2(2), 3 and 4 do not, except in favour of a person dealing as consumer, extend to the contract as it operates for and in relation to the carriage of the goods by that means.

4. Section 2(1) and (2) do not extend to a contract of employment, except in favour of the employee.

5. Section 2(1) does not affect the validity of any discharge and indemnity given by a person, on or in connection with an award to him of compensation for pneumoconiosis attributable to employment in the coal industry, in respect of any further claim arising from his contracting that disease.

Sections 11(2)  
and 24(2).

## SCHEDULE 2

### "GUIDELINES" FOR APPLICATION OF REASONABLENESS TEST

The matters to which regard is to be had in particular for the purposes of sections 6(3), 7(3) and (4), 20 and 21 are any of the following which appear to be relevant—

- (a) the strength of the bargaining positions of the parties relative to each other, taking into account (among other things) alternative means by which the customer's requirements could have been met;
- (b) 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;
- (c) 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);
- (d) where the term excludes or restricts any relevant liability 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 customer.

Section 31(3).

## SCHEDULE 3

### AMENDMENT OF ENACTMENTS

56 & 57 Vict.  
c. 71.

In the Sale of Goods Act 1893—

- (a) in section 55(1), for the words "the following provisions of this section" substitute "the provisions of the Unfair Contract Terms Act 1977 "
- (b) in section 62(1), in the definition of "business" for " local authority or statutory undertaker" substitute "or local or public authority".

1973 c.13  
1974 c.39

In the Supply of Goods (Implied Terms) Act 1973 (as originally enacted and as substituted by the Consumer Credit Act 1974)—

- (a) in section 14(1) for the words from "conditional sale" to the end substitute "a conditional sale agreement where the buyer deals as consumer within Part I of the Unfair Contract Terms Act 1977 or, in Scotland, the agreement is a consumer contract within Part II of that Act";
- (b) in section 15(1), in the definition of "business" for "local authority or statutory undertaker" substitute "or local or public authority".



SCHEDULE 4

Section 31 (4).

REPEALS

Chapter	Short title	Extent of repeal
56 & 57 Vict. c. 71.	Sale of Goods Act 1893.	In section 55, subsections (3) to (11). Section 55A. Section 61(6). In section 62(1) the definition of "contract for the international sale of goods".
1962 c. 46.	Transport Act 1962.	Section 43(7).
1967 c. 45.	Uniform Laws on International Sales Act 1967.	In section 1(4), the words "55 and 55A".
1972 c. 33.	Carriage by Railway Act 1972.	In section 1(1), the words from "and shall have" onwards.
1973 c. 13.	Supply of Goods (Implied Terms) Act 1973.	Section 5(1). Section 6. In section 7(1), the words from "contract for the international sale of goods" onwards. In section 12, subsections (2) to (9). Section 13. In section 15(1), the definition of "consumer sale".

The repeals in sections 12 and 15 of the Supply of Goods (Implied Terms) Act 1973 shall have effect in relation to those sections as originally enacted and as substituted by the Consumer Credit Act 1974.

1974 c. 39.

**Additional List of Organisations to whom  
Working Paper was circulated for Comment**

Hong Kong & Yaumati Ferry Co. Ltd.

Real Estate Developers Association of Hong Kong

Hong Kong Macao Hydrofoil Co. Ltd.

Hong Kong Metal Merchants' Association

Hong Kong and Kowloon Machinery & Instruments  
Merchants Association Ltd.

Hong Kong & Kowloon Electrical  
Appliances Merchants' Association Ltd.

Hong Kong and Kowloon General Association  
of Transportation and Navigation Merchants Ltd.

Hong Kong & Kowloon Confectionery  
Biscuit & Preserved Fruit Wholesalers Association Ltd.

Hong Kong & Kowloon Tea Trading Association

Hong Kong Computing Industry Federation

Hong Kong Cotton Spinners Association

Hong Kong Weaving Mills Association

Federation of Hong Kong Cotton Weavers

Hong Kong E & M Contractors Association

Federation of Hong Kong Watches Trade and Industries Ltd.

The Hong Kong Association of Banks

Secretary for Economic Services

Secretary for Trade and Industry

Mr. Michael Somerville  
Lombard Insurance Group

Mr. Patrick Poon  
Life Insurance Council

Mr. W. Stewart  
Wheelock Marden & Stewart Ltd