

## Exclusion Clauses Part 1: Drafting Tips

### Introduction

It is a common feature of modern business that when contracting commercial parties seek to reduce their potential liability in whole or part. This will be of particular relevance to Japanese companies which enter high-value international contracts, for example in industries such as energy, infrastructure and construction and also for the international sale of goods.

In the negotiation of such contracts, the scope, validity and enforceability of the exclusion or limitation clauses<sup>1</sup> will be a focus as the parties' respective potential exposure to liability may affect their anticipated profits from the contract and in turn the balance of the contractual terms agreed between the parties.

In this newsletter, the first of a two part series, we revisit the topic of exclusion clauses (last covered in Newsletter No.52 of December 2006) and examine factors which courts and tribunals will take into account when interpreting and ruling on the enforceability of exclusion clauses under English law. The second newsletter in the series will provide an analysis of the recent case of *Internet Broadcast Corporation Ltd v MAR LLC*<sup>2</sup> which considered whether a party can rely on an exclusion clause in respect of its own intentional breach.

### Matters of Interpretation

Under English law, exclusion clauses have traditionally been interpreted strictly with any ambiguity construed against the party seeking to rely on the exclusion or limitation. In order to ensure that an exclusion clause has its intended effect, clear and unambiguous drafting should therefore be used.<sup>3</sup>

In respect of clauses which limit but do not exclude liability entirely, however, English case law has generally adopted a more lenient approach.<sup>4</sup> The reason for the differing approaches appears to be the recognition that parties are more likely to have intended to agree to define and limit the scope of a party's liability for its contractual obligations, than they are to have intended to agree that a party should avoid entirely the responsibility for fulfilling its agreed obligations.

### Drafting Examples

When interpreting exclusion clauses, a court or arbitral tribunal will examine whether the precise wording of the clause clearly extends to the specific loss in question. It is therefore crucial to consider the potential losses that may arise in connection with the contract in order to draft an effective clause and such contemplated losses should ideally be expressly referred to in the drafting.

The following two examples provide illustrations of common situations where issues can arise when attempting to exclude or limit specific types of loss:-

#### (i) Excluding or Limiting Liability for Negligence

It is possible to exclude or limit liability for negligence under English law. However, the courts will require clear words to do so.<sup>5</sup> If an exclusion clause includes a clear, express reference to negligence, the courts will generally give effect to such clause.<sup>6</sup>

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<sup>1</sup> In the remainder of this newsletter, where we refer to exclusion clauses we are also including limitation clauses. Where the position is different in relation to limitation clauses this is referred to specifically.

<sup>2</sup> [2009] EWHC 844.

<sup>3</sup> Ailsa Craig Fishing Co Ltd. v Malvern Fishing Co [1983] W.L.R. 964 at 966 and 970.

<sup>4</sup> BHP Petroleum Ltd. v British Steel plc [2000] 2 All E.R. (Comm) 133 at 149.

<sup>5</sup> Gillespie Bros Ltd v Roy Bowles Transport Ltd [1973] Q.B. 400 at 419.

<sup>6</sup> Canada Steamship Lines Ltd. v The King [1952] AC 192; Biffa Waste Services Ltd v Maschinenfabrik Ernst Hese GmbH [2008] EWHC 6.

Where wider words are used,<sup>7</sup> the courts will examine whether the clause should be construed to include negligence based on the ordinary meaning of the words used. Even if the ordinary meaning of the words is considered wide enough to cover negligence, an English court will go on to consider whether a claim other than negligence is available in respect of the loss. Should another claim be available, the exclusion will not normally be held to extend to negligence.<sup>8</sup>

To avoid this uncertainty, it is prudent to make an express reference to negligence when drafting clauses attempting to exclude or limit liability for such loss.

(ii) *Relationship between "Indirect and Consequential Loss" and "Loss of Profit"*

It is increasingly common for commercial parties to attempt to exclude or limit liability for "*indirect and consequential loss*". In respect of breaches of contract, there are broadly two categories of loss under English law, namely:

- (i) Direct Losses: those which may fairly and reasonably be considered as arising naturally from a breach; and
- (ii) Indirect Losses: those which do not arise directly from a breach but were reasonably in the contemplation of the parties as a probable result of the breach when the contract was made.

Case law has established that the words "*indirect and consequential loss*" in commercial contracts will ordinarily be construed as the equivalent of the second of these two categories, Indirect Losses.<sup>9</sup> In our experience contracting parties often exclude "*indirect and consequential loss*" in an attempt to protect against, among other things, all loss of profits claims. The attempt may, however, prove to be in vain in respect of loss of profits which may be considered to fall within the first category, Direct Losses.

The recent case of *Ferryways NV v Associated British Ports*<sup>10</sup> highlights that where an exclusion clause refers to "*indirect and consequential loss ... very clear words indeed [are required] to indicate that the parties' intentions when using such words was to exclude losses which fall outside that well-recognised meaning*".<sup>11</sup>

An exclusion or limitation of "*indirect and consequential loss*" will therefore ordinarily not extend to loss of profits which are recognised as Direct Losses. Clear words beyond "*indirect and consequential loss*" will therefore be required to exclude entirely all loss of profit claims.

### Unfair Contract Terms Act 1977 ("UCTA")

UCTA provides a further layer of legislative protection that regulates attempts to exclude or limit liability for breach of contract and negligence in contracts governed by English law. Where an exclusion clause is subject to UCTA, it will only be enforceable if the term can satisfy the statutory requirement of reasonableness.<sup>12</sup>

The scope of the application of UCTA to Japanese companies is, however, potentially limited. Where a Japanese company is contracting with a non-UK counterparty in relation to non-UK business, UCTA is unlikely to apply even if English law is chosen to govern the contract.<sup>13</sup> However, a Japanese company should remain cautious of UCTA's application to contractual exclusion clauses in contracts governed by English law where there is a substantial connection with the UK, in particular when contracting with a consumer or on its standard terms.

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7 Examples in case law include "no liability whatever", "under no circumstances" and "all liability".

8 *Canada Steamship Lines Ltd. v The King* [1952] AC 192 at 208.

9 *Hotel Services (UK) Ltd. v Hilton International Hotels (UK) Ltd.* [2000] 1 All E.R. (Comm) 750; *Watford Electronics Ltd. v Sanderson CFL Ltd.* [2001] EWCA Civ 317.

10 [2008] 2 All ER (Comm) 504.

11 [2008] 2 All ER (Comm) 504 at 521.

12 A full discussion of the concept of reasonableness and the application of UCTA is beyond the scope of this newsletter. If you are concerned that a clause may fall foul of UCTA further advice should be sought.

13 UCTA section 27(1).

## Conclusion

The commercial risk associated with an ineffective exclusion clause can be substantial. Japanese companies should therefore be aware of the approach a court or tribunal will take to exclusion clauses when drafting contracts governed by English law or when seeking to rely such clauses in the course of a dispute. The following specific points should be borne in mind:

- Clarity of drafting is crucial to avoid giving the courts an opportunity to construe the term against the party relying on the exclusion clause;
- Potential avenues of loss should be considered prior to drafting and specific wording should be included to cover such losses;
- When attempting to exclude or limit liability for negligence it is prudent to refer specifically to "*negligence*"; and
- By relying simply on a term excluding "*indirect and consequential loss*" a contracting party risks remaining liable for claims for loss of profits which a court or tribunal considers to flow directly from a breach.

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The content of this article does not constitute legal advice and should not be relied on as such. Specific advice should be sought about your specific circumstances.

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