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With this thought, we hereby present to you

LEX BONA FIDE: LAW JOURNAL

A COMPARATIVE ANALYSIS OF U.K AND INDIAN LAW RELATING TO EXCLUSION AND LIMITED LIABILITY CLAUSES UNDER LAW OF CONTRACT

(By Mr. Nachiketa Joshi, Advocate, Supreme Court of India)

INTRODUCTION

In India Section 73 and 74 of the Indian Contract Act, 1872 talk about the damages to be awarded in case of breach of contract. According to Section 73 of the Contract Act, if a party suffers a loss as a result of a breach of contract, he is entitled to compensation from the party who breached the contract. Compensation will be paid for losses that naturally arose from the breach or that the parties knew would likely arise from a breach at the time the contract was made. Under section 73 of the Act, no compensation will be granted for remote and indirect losses.

The division between damages towards losses has been borrowed from the famous English case of *Hadley v. Baxendale*, they are divided as losses which occur in the usual course of business and losses which the parties knew at the time of making the contract will likely occur from a breach. Losses that occur in the usual course of business are known as General damages whereas losses caused by a breach outside the usual course of business that parties have contemplated are known as Special damages.

Parties to a contract can exclude or limit the liability for a certain type of loss by drafting exclusion or limited liability clauses. Though these clauses are largely enforced they can be subject to public policy and the bargaining power of parties.

The purpose of this study is to compare Indian and English jurisprudence on exclusion clauses, which are used to limit or exclude liability arising from contractual agreements.

GROWTH OF EXCLUSION AND LIMITED LIABILITY CLAUSES

Exclusion clauses function in the same way as any other provision of a contract and thus are binding on parties to a contract. The enforceability of such clauses will not be refused on the ground of consequent hardship. In *Bharti Knitting Company v. DHL Worldwide Express Courier Division of Airfreight Ltd*

The Supreme court deal with the limited liability clause mentioned in the terms and conditions of consignment note lessens the liability of the postal company in case of any breach in delivery of goods. The decision of NCDRC was upheld by the Apex Court which limited the amount provided to the consignor for breach, to the sum provided in the limited liability clause. The Apex court rejected the contentions of the party that the other party has no knowledge of the limited liability clause and held that once the parties enter into a contract, they are bound by it. This case is a typical description of the “duty to read” doctrine which assumes that the parties of the contract know the terms of the contract.

As a result of this broad approval, a free domain was provided for the operation and development of the exclusion clauses. But such approval also brings with it the power to misuse, now the entities take advantage and draft clauses by excluding their liability to great extent. This was mostly seen in contracts where the parties have unequal negotiating power, like in standard form contracts. Consider a case in which a corporate organization transacts with a single individual who has limited bargaining power or none at all. This gives the seller the power to introduce conditions that are favorable to him and state that “ the services will be available only on these conditions its your choice whether to take it or leave it”. These types of contracts restrict the freedom of contract which in turn violates the fundamental principle of the law of contract.

With the aim to provide solutions in such cases the Unfair contract terms Act, 1977 was introduced in the UK, the Act grants authority to the courts to declare any unreasonable exclusion clause of a contract as void. In a similar vein, India has implemented the Consumer Protection Act of 2019, which provides for remedies in the event of unjust consumer contracts.

ENGLISH LAW ON EXCLUSION AND LIMITATION OF LIABILITY CLAUSES

The use of the Exclusion or limitation of liability clause is more consistent in England. Whenever English courts are encountered standard form contracts or contracts where there is unequal negotiating power, they apply the test of reasonableness or fairness in such cases and declare terms of the contract that are immoral or exploitative as void.

The Unfair Contract Terms Act of 1977 ("UCTA") deals with exclusion or limitation of liability clauses, it sets out the bar to which exclusion or limitation of liability of clauses can be used to avoid the contractual liability. Provisions to exclude liability for death or grievous injury as a consequence of negligence are void, whereas provisions excluding liability for any other loss or damage as a result of negligence must pass a reasonableness test. If one party agrees to contract

on terms of the other party, the latter cannot dismiss or limit any liability in respect of his breach by referring to any term of the contract, unless the contractual term meets the reasonableness criterion. This only applies in situations where one of the parties' contract conditions governs both parties. The above provision does not apply to the international sale of goods contracts, i.e. contracts made between parties whose places of business are located in separate countries.

A term is reasonable, according to the UCTA, if it is fair and logical to include, taking into consideration elements that were known to or in the minds of the parties at the time of the contract formation. While determining whether a limitation of liability to a specific amount of money satisfies the reasonableness conditions, factors that have to be considered are the funds that the individual limiting his liability could expect to have available for the purpose of meeting the liability, as well as the extent to which he could cover himself with insurance. Other criteria for establishing reasonableness include the strength of the parties' negotiating power in relation to one another, whether the choice of the term of the contract was given to the other party, and whether the party knew the term's existence and scope. The person asserting that a contract falls under the standard of reasonableness bears the burden of proof under the UCTA. The Consumer Rights Act of 2015 governs consumer contracts, and the majority of the UCTA's standards do not apply to them.

In *Watford Electronics Ltd v. Sanderson CFL Limited* it was held by the English Court of Appeal that “when experienced businesspeople representing large corporations with equal negotiating power negotiate an agreement, they are presumed to have knowledge of the information available to them. They should, in the court's opinion, be considered the best judge of the business fairness of the agreement they have reached, including the fairness of each of the provisions in the contract. They should be trusted to decide if the agreement's provisions are reasonable. The court should not assume that either is likely to bind his company to an agreement that he considers to be unfair or contains unreasonable clauses. The court should not intervene unless it can be seen that one party has taken unfair advantage of the other – or that a term is so irrational that it cannot be properly evaluated.” In this case, the court determined that the relevant contract clause was reasonable for the purposes of the UCTA because it excluded liability for indirect and consequential losses and limited liability for losses resulting directly from breach of contract.

INDIAN LAW ON EXCLUSION AND LIMITATION OF LIABILITY CLAUSES

In India, there is no law prohibiting the exclusion or limitation of liability for damages. However, Section 23 of the Indian Contract Act, 1872, states that consideration in a contract is unlawful if

it defeats any provision of any law currently in force or if the court considers it unconscionable or contrary to public policy. An agreement is void if its object and consideration are unlawful.

If a limited liability clause is mentioned in the contract which specifies the sum to be paid at the time of breach of contract, then the mentioned sum can be enforced under Section 74 of the Indian Contract Act, 1872. The amount to be paid on breach of contract will not exceed the amount mentioned in the clause. For example, if a contract contains a clause which says that in case of breach the maximum penalty shall be Rs 20,000/-, then the amount can not exceed Rs, 20,00/-.

Where the court finds out that parties to the contract have unequal negotiating power, it may declare the immoral excluding or limiting liability clauses as void. In the case of Central Inland Water Transport Corporation. v. Brojo Nath Ganguly Brojo Nath Ganguly Supreme court evolved the principle that no unfair or unconscionable contract or term in the contract will be enforced if there is unequal negotiating power between parties. It also mentions some instances of unequal negotiating power between parties, including where it is an outcome of the difference in the economic strength of the parties to contract, where goods can be obtained by a weaker party only on the terms and conditions of the stronger party. Despite the fact that the court was dealing with an unjust termination provision, the aforementioned decisions were made in a broader context, and after reference to English judgments dealing with commercial problems, including contracts including exclusion or limitation of liability clauses. Further, the court said that the above principle will not be applicable in cases where the contract is a commercial transaction and both the parties are a businessman or where both the parties of the contract have equal negotiating power.

In *Simplex Concrete Piles (India) Limited v. Union of India* Delhi High court discussed whether an exclusion or limited liability clause can prohibit a person from claiming damages which he has a legal right to claim i.e can parties contract outside the purview of section 73 of the Contract Act. In this case, the court looked at a condition in a government construction contract that states that if the work is not completed on time or the completion time is extended due to reasons beyond the contractor's control, a claim for reimbursement from the contractor will be denied.

The Delhi High Court issued the following ruling:

1. By virtue of Section 23 of the Contract Act, terms that restrict and prohibit a contractor from claiming damages that he is entitled to under Sections 55 and 73 of the Contract Act are void.

2. Individuals can waive a law that is enacted for their own benefit, but the same cannot be waived when the legislation incorporates a public interest/public policy element, since the law becomes a matter of public policy/public interest.
3. Clauses like the one, in this case, are null and void under Section 23 of the Contract Act because they are against the public interest and policy.

REMEDIES AGAINST UNCONSCIONABLE TERMS OF CONTRACT

There is no provision in Indian Contract Act, 1872 that deals with unconscionability. Nonetheless, the remedy has been identified by the courts under Section 16 which explains undue influence read with Section 19A, according to which any contract affected by undue influence is void at the option of the party whose consent is taken by undue influence and has also considered contentions of the party that undue influence is the reason of the unconscionable terms in the contract. A contract is said to be affected by undue influence only if one party is in a position to vitiate the will of the other party and take unfair advantage of such a position.

Prior to the UCTA, the UK courts had also awarded relief to the party who had been subjected to undue influence as a result of unequal negotiating power and declared the contract void. However, the Indian courts have frequently stated that unless unequal negotiating power is the consequence of undue influence, the unconscionable transaction cannot be terminated. The Supreme Court of India has stated that if the parties knowingly enter into an unconscionable contract, the law will not be able to save them thereafter.

The presumption of Undue influence can only be used in some specific cases like employer-employee cases it cannot have universal application. The Act's section 23 is an exception to this rule. It declares that a contract is void if the court considers the consideration or object of the contract to be unlawful or immoral.

In *Sheik Mahamad Ravuther v. The British India Steam Navigation Co Ltd.*, the defendant corporation included an exclusion clause to shield itself from any liability coming from its helpers' negligence. Though the majority maintained the exclusion clause, Shankaran Nair, J.'s opinion, noting that the exclusion clause is contrary to public policy under section 23 and so the defendant corporation is liable for negligence, is noteworthy. In a further case the court considering this dissent held in many cases that unconscionable contracts are unlawful. Like in *Lilly White v. Mannu Swami* case the court considered the question that whether a limiting liability clause stating that “in case of loss only 50% of the amount will be returned” be added to

the slip of dry cleaners. The court held that a clause like this will give an undue advantage to drycleaners to misplace customers' goods and such terms are against public interest so thus these terms cannot be included. Also, the law commission of India in its report has said that section 23 " safeguards public welfare and it's a provision under which freedom of contract is limited by law for the benefit of the public."

Further, Indian courts have demonstrated exceptional reluctance to invoke section 23 in private business contracts, concentrating solely on the concept of freedom of contract. Thus, the remedies under the Contract Act appear insufficient to deal with contractual provisions that are irrational.

WAY FORWARD

Although Indian law has introduced statutory protection against substantive unconscionability and through Consumer Protection Act, 2019 vested the power in the judiciary to examine consumer contracts, but still, the insufficiency of addressing unfairness and unconscionability under basic principles of contract law persists. Some of the suggestions on this are:

1. Indian Contract Act should be amended and Section 67A should be added as suggested by Law Commission in its 103rd report. According to the report Section, 67A read as follows:
 - Where the court finds out that the contract or any term of the contract is unconscionable then the court should declare such a contract or term of the contract void.
 - A contract or provision of the contract is considered to be unconscionable if it exempts any party from liability for wilful breach of contract.

The addition of this section will provide the court with the power to examine unconscionable terms independent of the argument on freedom of contract' or 'undue influence. This section is written in the same way that the United States Uniform Commercial Code's Section 2-302 is written.

1. In India, a law similar to the Unfair Contract Terms Act, 1977 should be adopted. The same has been suggested by the Law Commission of India in its 199th report, even a draft of the "the Unfair (Procedural and Substantive) Terms in Contract Bill, 2006" has been provided by the commission. The bill tries to enact a law similar to the Unfair Contract Terms Act, 1977 which gives judges the power to "provide various reliefs to the parties from the consequences of unfairness in contracts."

CONCLUSION

Free contracting is one of the most important characteristics of a modern state. The same approach is adopted by the Indian Contract Act while validating exclusion clauses, according to the act if the clauses are drafted properly and inserted after the other party agrees then they are valid. But if the same is affected by unfair and unconscionable terms then they are void. Present remedies in Indian Contract Law are inadequate for substantive unconscionability. Thus, the parliament should consider the recommendations made by the Law Commission in its 103rd and 199th report and amend the present Indian Contract Act.

