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External in-house counsel

EXCLUSION CLAUSES – FRAUD EXCEPTIONS IN CONTRACTS

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On 30 January 2018, the Court of Appeal (the “**Court**”) provided important guidance on the interpretations of exclusion clauses in the case of fraud in *Interactive E-Solutions v O3B [2018] EWCA Civ 62* (the “**Interactive Case**”).

INTERACTIVE CASE

The Interactive Case involved a claim for unpaid fees arising from the provision of satellite bandwidth by O3B (the “**Claimant**”) to Interactive (the “**Defendant**”) for onward sale to mobile telephone operators in Pakistan. The Defendant alleged that certain regulatory approvals were not obtained from Pakistan by the Claimant and brought a counterclaim for breach of contract, and loss of profits amounting to \$55 million.

The Defendant faced a hurdle in that the contract already prescribed a contractual remedy in place of damages in the event of a breach by the Claimant. To overcome this, the Defendant sought to rely on a ‘fraud’ exemption to the exclusion clause, claiming that a third party, the Claimant’s subcontractor, had been fraudulent when seeking regulatory approval. However, the Defendant failed to prove that the Claimant themselves had been fraudulent in the provision of services.

The Court considered the wording of a fraud exception in a contract and held that to rely on the fraud exception, fraud would need to be a necessary ingredient of the legal basis on which loss is claimed. The Court dismissed the appeal and held that fraud and dishonesty claims fell outside the scope of the exclusion of liability.

DRAFTING CONSIDERATIONS

The Interactive Case shows the Court’s changing approach towards exclusion clauses, with the acceptance that such clauses are an integral part of pricing and risk allocation in commercial contracts post-Unfair Contract Terms Act 1977.

However, the Court warns that an exclusion clause that is drafted too broadly may be ineffective because it would be unreasonable to exclude fraud. As a result, it has become common to include a fraud carve-out in exclusion clauses to reflect that a contracting party may be prepared to assume the risk of negligence by his counterparty, but not the risk of fraud.

NEXT STEPS

For more information, and any guidance or advice on the enforceability of your contracts, Cleveland & Co External in-house counsel, are here to help.

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