CONSTRUCTION & ENGINEERING BRIEFING

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Caps on Liability - how are they applied by the courts?

In a recent case that came before the High Court, the Court considered a contract clause which attempted to impose a financial cap on the contractor's liability. The case acts as a reminder to those who negotiate and draft construction and engineering contracts to be mindful of the scope and ambit of these clauses.

In engineering, construction and infrastructure projects, it is not unusual for the contractors that are engaged and the consultants that are appointed to seek to limit their potential liability under the contracts they enter into. One way they attempt to do this is by agreeing with their employer, a financial cap on the contractor's or consultant's liability under its contract. Requests for financial caps on liability have become more frequent, as have other clauses seeking to exclude or limit liability - sometimes at the request of professional indemnity insurers.

Industry form construction contracts tend to include provisions that seek to limit liability on the part of the contractor/consultant (particularly in process engineering contracts), whilst bespoke forms of contract and collateral warranties will not usually include financial caps on liability unless specifically negotiated and agreed between the parties.

It is of paramount importance that exclusion and limitation clauses are drafted clearly; the courts will interpret any ambiguity in an exclusion or limitation clause against the party seeking to rely on it ("*contra proferentem*"). The recent decision in Sabic Petrochemicals has highlighted this and the importance of clear drafting.

RECENT COURT DECISION

In *Sabic Petrochemicals Limited v Punj Lloyd Limited* (2013), the Technology and Construction Court considered the effect of a limitation of liability clause in respect of a claim for the employer's costs incurred in completing the works following termination of the contractor's engagement. The decision also made important findings as to how monies paid out under guarantees should be accounted for in the context of the cap on liability.

THE FACTS OF THE CASE

Sabic Petrochemicals Limited ("**Sabic**") engaged Simon Carves Limited ("**SCL**") to design and construct a polyethylene manufacturing plant in Wiltshire. SCL's parent company, Punj Lloyds Limited ("**PLL**"), provided a parent company guarantee in respect of SCL's performance of the contract. SCL subsequently went into administration.

During the course of the works, it became clear that the completion date would not be achieved. A supplemental agreement was entered into which identified a critical date as the new completion date. In return, Sabic agreed to make payment of the whole

of the balance of the existing contract price against which SCL provided an advance payment guarantee.

When matters did not improve, Sabic terminated the contract and completed the project itself. It then issued proceedings against PLL to recover the costs and losses arising from the delays under the advance payment guarantee and parent company guarantee ("Guarantees").

CAP ON LIABILITY

Sabic's contract with SCL contained a limitation of liability clause limiting the aggregate liability of SCL "*under or in connection with the Contract (whether or not as a result of the Contractor's negligence and whether in contract, tort or otherwise at law ... shall not exceed 20% (twenty per cent) of the sum of the Contract Price plus or minus the value of any Variations issued prior to the date of Mechanical Completion*".

In the TCC, the court held that this clause applied only to the employer's claim for damages and not to any accounting exercise required by the termination provisions of the contract. In other words, the limitation would only be relevant if some of the employer's costs related to claims for damages for breach of contract.

EFFECT ON THE GUARANTEES

The court indicated that had the cap on liability applied to Sabic's claim for the cost of completing the works following termination of SCL's engagement under the contract, the court held that the amount paid out under the guarantees should be deducted from the Sabic's loss before the cap on liability was applied. The effect of recovery under the guarantees would reduce the employer's loss against which the cap would apply.

IMPLICATIONS

This decision reinforces the strict approach adopted by the courts when asked to interpret such clauses, and as such, if the intention is for the clause to include all amounts payable by the contractor, the clause must expressly state this is the case.

Where the parties intend a cap on liability to include and take into consideration accounting processes undertaken following termination of the contractor's engagement and any sums recovered under any guarantees, specific drafting will be necessary.

OTHER CONSIDERATIONS

When considering whether a cap on liability is commercially acceptable, it is important to consider whether the contractor would have the resources to make payment of potential losses, the financial strength of the contractor, the amount of any insurances maintained (which may cover the losses incurred) and the availability of guarantees or other security provided by third parties.

There may be other provisions of the contract which could operate as an alternative to, or in addition to, the cap on liability. For example, net contribution clauses, which are often found in collateral warranties; would these apply in addition to or instead of a cap on liability? It may all turn on the drafting of the clauses.

In addition, where standard terms of business are used to engage contractors and consultants, it should be borne in mind that a cap on liability which is contained in standard terms and conditions may be subject to the "reasonableness" requirements of the Unfair Contract Terms Act 1977.

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For more information or to request additional information on WIN please contact Richard Norman or Bethany Jennings via www.dlapiperwin.com.

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