

# **Don't Bet the Company: Limiting Liability with Effective Exclusion and Limitation Clauses**

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# Exclusion and Limitation Clauses

## Overview

1. Context
2. Basics
3. Excluding liability
  - for 'consequential loss'
  - for negligence
4. When are they not permitted or are controlled?
5. Examples and key points



# Exclusion and Limitation Clauses

## Context

- It's all about risk and liability!
- Generally, the liability associated with the occurrence of risks related to commercial transactions is dealt with using 3 methods:
  - transferring or limiting liability
  - insurance
  - managing the risk
- Exclusion and limitation of liability clauses are a common but powerful mechanism used to transfer or limit a party's liability associated with risk



# Exclusion and Limitation Clauses

## Context (cont.)

- Useful to **differentiate** the different contractual mechanisms through which risk and liability can be defined and regulated
- Other mechanisms include:
  - Indemnity clauses
  - Security clauses
  - Guarantees





## Managing the risk?



# Exclusion and Limitation Clauses

Basics – what are they and what do they do?

Exclusion clauses:

- **exclude entirely** a party's liability to another party for damages (on the basis of a breach of contract or in tort)

Examples:

- exclusion of liability for 'consequential loss'
- 'time bars'



# Exclusion and Limitation Clauses

Basics – what are they and what do they do? (cont.)

Limitation clauses:

- have the effect of **limiting or quantifying** a party's liability for damages
- **do not** completely absolve a party from damages for a nominated liability

Examples:

- liquidated damages for delay or performance
- an overall 'cap' of liability or 'sub-caps' for particular types of liability



# Exclusion and Limitation Clauses

## Basics – why use them?

- Exclusion and/or limitation clauses are used to alter the extent of liability otherwise recoverable at common law
- Exclusion and limitation clauses allow parties to better:
  - **allocate** risk and responsibilities
  - **define the extent** of liability for losses covered by the clause
  - **pre-agree** the maximum damages for which it may be liable, and allow an appropriate contingency
  - **regulate** the circumstances, time and extent to which liability may run under a contract



# Exclusion and Limitation Clauses

## Basics – how to interpret them

- When construing an exclusion or limitation clause a court will consider the **intentions of the parties** and the **contract as a whole** in determining whether the clause will apply to exclude or limit the liability of a party
- *Darlington Futures Ltd v Delco Australia Pty Ltd* (1986) 161 CLR 500



# Exclusion and Limitation Clauses

## Basics – key principles for drafting and interpreting

1. Exclusion and limitation clauses will be construed strictly against the person seeking to rely upon them
  - the more serious the breach, the less likely it is for the parties to have intended an exclusion or limitation for liability to apply
  - the reasonableness of an exclusion or limitation clause may be relevant
  - the relative bargaining power of the parties may be relevant



# Exclusion and Limitation Clauses

## Basics – key principles for drafting and interpreting (cont.)

2. The courts will generally be more reluctant to find ambiguity in an exclusion or limitation of liability clause where the parties to the contract are significant commercial entities
3. An exclusion or limitation clause will not generally be enforced where:
  - the beneficiary of the clause has committed a breach of a fundamental term of the contract
  - the exclusion clause defeats the main purpose of the contract



# Exclusion and Limitation Clauses

Basics – key principles for drafting and interpreting (cont.)

## 4. The 'nexus' phrase is important:

- 'relating to'
- 'in connection with'
- 'arising out of'
- 'as a result of'
- 'caused by'



# Exclusion and Limitation Clauses

## Consequential loss

- Clauses are commonly included in supply and construction contracts to exclude or limit 'indirect', 'special' or 'consequential' losses
- Why? Such losses are difficult to predict and price and some companies cannot face exposure to unlimited (and uninsured) damages
- Can benefit both parties
- But ... what does 'consequential loss' mean?



# Exclusion and Limitation Clauses

## Right to damages for breach of contract

- General damages is in the absence of any exclusion of 'consequential loss'
- Breach of contract
  - Innocent party to be put in the position as if the bargain had been performed (subject to proof, causation and 'remoteness')
  - Remoteness of loss is assessed against the rule in *Hadley v Baxendale* (1854) 156 ER 145:
    - **'Direct Losses'** – losses arising naturally, according to the usual course of things from the breach of contract
    - **'Indirect Losses', 'Special Damages' or 'Consequential losses'** – other losses the parties reasonably knew when they contracted would be the probable result of a breach



# Exclusion and Limitation Clauses

## Excluding 'consequential loss' – drafting tips

- **Tip 1 – do** explicitly describe the losses to be excluded, as separate items

*Subject to clause #, and to the extent permitted by law, the contractor is not liable to the principal under or in connection with this agreement for:*

- *any cost, expense, loss or damages of an indirect or consequential nature;*
- *any loss of profit, use, goodwill, revenue, business, production, opportunity, anticipated savings;*
- *delay (other than for liquidated damages in accordance with clause #)....etc*



# Exclusion and Limitation Clauses

## Excluding 'consequential loss' – drafting tips (cont.)

- **Tip 2 – don't** list losses as 'subsets' of consequential loss

### Risky drafting approach

*The contractor is not liable to the principal for consequential loss, including loss of profit or anticipated business.*

- Risk is that 'direct' loss of profit might not be excluded, only 'indirect' loss of profit (if *Hadley v Baxendale* and *Pegler v Wang* followed)



# Exclusion and Limitation Clauses

## Excluding 'consequential loss' – drafting tips (cont.)

- **Tip 3** – If acting for a purchaser/principal be careful to exclude the supplier/contractor's liability for 'consequential loss'
  - *Peerless* appears to have significantly broadened what this means
  - Rather than relying upon the expression 'consequential loss' or 'indirect loss', spell out what you mean
  - Don't rely on the Court to interpret what you mean



# Exclusion and Limitation Clauses

## What about negligence?

- Liability for negligence **can** be excluded
- The intention to exclude negligence must be clear
  - Expressly using the word 'negligence' is best
  - Otherwise, the courts will consider whether the words used are broad enough to exclude liability for negligence, in light of the contract as a whole
    - Excluding 'all liability' may or may not exclude liability for negligence
    - Excluding 'all liability whatever its cause' or 'howsoever caused' is more likely to exclude liability for negligence





Negligent?



# Exclusion and Limitation Clauses

When cannot liability be excluded?

- Parties are generally free to limit or exclude liability
- Statute also provides some liability caps
- Exceptions to right to exclude liability include:
  - fraud
  - fundamental breach
  - unequal bargaining power – unconscionable conduct
  - legislative restrictions on excluding liability – especially *Trade Practices Act*



# Exclusion and Limitation Clauses

## Practical examples

- In drafting exclusion and limitation clauses, parties will need to consider the inter-relationship between those clauses and the other provisions of the contract
- Consider 'carve-outs' from a liability cap
- Open or closed list?
  - For example:

*Direct damages include, but are not limited to:*

- *costs of replacing lost, stolen or damaged goods or materials ..*



# Exclusion and Limitation Clauses

## Key points

- Start position is that a party is entitled to recover 'direct' and 'indirect' losses incurred as a result of a breach subject to remoteness test in *Hadley v Baxendale*
- Use exclusion and limitation clauses to alter the extent of liability otherwise recoverable at common law
- The meaning of 'direct', 'indirect' or 'consequential' is not certain at common law – need to draft meaning of those terms in a contract



# Exclusion and Limitation Clauses

## Key points

- To interpret an exclusion or limitation clause a court will consider the intentions of the parties and the contract as a whole
- Be aware that some legal and statutory limitations apply to exclusion and limitation clauses
- You can exclude liability for negligence but you should expressly refer to it
- Carefully consider the relationship between exclusion and limitation clauses and the other provisions of the contract



# Questions?

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