

LIMITING LIABILITY IN COMMERCIAL CONTRACTS

An exclusion, limitation or exemption clause in a commercial contract seeks to exclude or limit a party's liability, or exclude or limit the other party's rights or remedies

Examples include:

- financial cap on overall liability and/or caps on different liabilities;
- setting fixed or "liquidated damages" or "service credits" payments;
- exclusion of specific heads of loss, such as loss of profits, revenue, anticipated savings, data, etc.;
- exclusion of consequential or indirect losses;
- time bars on claims, both within and after the term of the agreement;
- exclusion of certain warranties, conditions or other terms implied by statute or otherwise, e.g. satisfactory quality and fitness for purpose etc.;
- excluding liability due to force majeure, i.e. matters beyond one's reasonable control;
- exclusion of specific remedies, e.g. specific performance, set-off rights;
- conditions to specific remedies, e.g. paying the return costs of defective goods;
- reverse indemnities, e.g. customer indemnifying supplier for liability beyond that expressly accepted by supplier;
- entire agreement clauses and non-reliance upon prior representations.

Liquidated damages and service credits

It may also be helpful for a supplier to clearly state that it is not taking responsibility for particular activities, e.g. not being responsible for verifying the purchaser's specification or not being responsible for failings in third party networks. However, note that sometimes this sort of provision can be construed as an exclusion clause which is subject to the tests mentioned below.

EFFECTIVENESS

For an exclusion clause to be effective, it must pass at least these tests:

- it must have been incorporated into the agreement;
- its wording must cover the liability in question;
- it must not be prohibited by statute or other law – e.g. under the Unfair Contract Terms Act 1977 (“UCTA”), the Consumer Rights Act 2015 (“CRA”) or the Consumer Protection Act 1987. Note that UCTA does not apply to some contracts e.g. certain international sales, insurance, intellectual property, securities and land contracts.

Consumer Rights Act 2015 (“CRA”)

Incorporation

Particularly where the parties are dealing on unsigned business terms (e.g. order forms with standard terms and conditions on the reverse), there can be difficulty in deciding whether one party's terms are incorporated in the contract. If not, any exclusion clauses in the terms will be ineffective. This can be a particular problem in so-called 'Battle of the Forms' situations, when a supplier may find that the purchaser's terms apply - perhaps, if these were the last terms submitted before the contract was treated as formed.

Even in a formal signed contract, exclusion clauses in the main body of the contract can be inadvertently overridden by other provisions (e.g. in schedules or annexes) which may be expressed to override the main body.

Consumer Protection Act 1987

Ideally, exclusions should be brought to the attention of the other party before the contract is signed, and this will come under particular scrutiny in consumer contracts.

Construing the clause

There has been judicial hostility to exclusion and limitation clauses, which can make them hard to "stick" if tested in the courts. In particular, if there is any ambiguity in the wording of such a clause, it will be construed against the party seeking to rely on it. The provision must be comprehensive so it is clear that it covers the liability. This can lead to lengthier clauses to try to ensure all types of losses and all circumstances are captured.

One must consider what the clause needs to cover. This involves a consideration of at least these areas:

What type of defective performance may arise?

A supplier is likely to want the clause to cover each of the following:

- a complete failure to perform;
- delay in performance;
- defective performance or supply of defective product.

It has been held that there is no reason why an exclusion clause cannot cover "fundamental breach" if it is drafted widely and clearly enough. However, the common law will not generally allow a clause to relieve a contractor from all liability or enable it to provide a completely different supply than that which is agreed in the agreement.

It may be effective to expressly exclude liability for wilful default (many breaches have an element of a knowingly deliberate act or omission) but not, for instance, acts which are malicious, fraudulent or in bad faith.

What type of legal action may arise?

A simple exclusion clause in a contract may be construed as only covering breach of contract, but normally a supplier will want to cover non contractual claims too, for example:

- negligence;
- misrepresentation;
- breach of statutory duty.

There have been cases where general words, such as “actions or liability however caused”, without further elaboration, have been held to cover negligence, but it depends upon the context. It is therefore safer for suppliers to expressly list all relevant causes of action they wish to exclude.

Excluding certain type of damage or loss

Suppliers may want to exclude certain types of loss altogether (rather than just include them in the financial cap). Such losses often include loss of anticipated savings, profit, revenue and data. However, suppliers need to be careful not to exclude all the customer’s potential heads of loss leaving the customer without any substantial remedy, as this is unlikely to be upheld by a court, if challenged.

Unenforceable Exclusions or Limitations

These include clauses which purport to limit liability:

- for death or personal injury caused by negligence;
- for fraud or fraudulent misrepresentation;
- for lack of clear title in a sale or hire purchase of goods;
- for non-conformity with implied terms, e.g. of satisfactory quality of goods – where one party contracts in the course of a business and the customer is a “consumer” as defined in CRA.

Any attempt to exclude liability which is prohibited by law may put in jeopardy the whole exclusion clause. It is therefore generally advisable to state expressly that one is not excluding or limiting liability in the cases mentioned above or otherwise not permitted by law.

There are also a range of situations under UCTA where validity of a particular exclusion or limitation depends upon the ‘reasonableness’ of the clause.

THE REASONABLENESS TEST - UCTA

Unfair Contract Terms Act 1977 (“UCTA”)

UCTA imposes a reasonableness test on many exclusion clauses, for example:

- limitations of liability for negligence;
- limitations of liability for (non-fraudulent) misrepresentation; or
- limitations of liability for breach of statutory implied terms, e.g. of satisfactory quality or fitness for purpose.

What constitutes “standard terms” is not straightforward. It should apply to a set of terms all of which had been fixed by the supplier, but it has been found by the Court of Appeal to also apply to a single exclusion clause where the supplier’s standard terms were negotiated, but the exclusion clause remained unchanged.

To pass the reasonableness test, the clause must be fair and reasonable in the circumstances which were, or ought reasonably to have been, known to, or in the contemplation of, the parties at the time of entry into the contract. There are many factors to be considered by the court including:

- the relative abilities of the parties to meet the loss or obtain insurance - and their actual cover;
- the extent to which the exclusions were made known (e.g. use of bold print);

- whether less severe exclusion terms were available if the customer had been prepared to pay a higher price for them.

FINANCIAL CAP

There is no general rule as to what level of financial cap will be effective. Some businesses seek to set the cap equal to the overall price of the supply. This has been accepted by the courts as reasonable in some but not all cases. A supplier may consider setting the cap at a multiple of the price (e.g. 120%) and have different caps for different liabilities, e.g. a higher limit for liability arising from physical damage caused by the supplier's own negligence, as the supplier's insurance may cover this (any insurance policy must be carefully checked, however).

"CONSEQUENTIAL" LOSS

Indirect or
consequential loss

Many supplier businesses have a policy that they will not accept liability for consequential or indirect losses. Case law shows that it can be difficult to know whether a loss is "consequential" (or indirect) or whether it will be treated by the courts as a "direct" loss. Broadly "direct" losses are those arising naturally from the breach, which would be viewed as "not unlikely" to arise. As the courts often find losses to be direct rather than indirect, an exclusion of "indirect and consequential" losses can give a false sense of security. Therefore, it is usually preferable to exclude liability also for any specific categories of loss that you are not prepared to accept liability for, e.g. for loss of revenue or profits (whether direct or indirect) as well as all indirect and consequential losses.

Several cases have highlighted the need for care in drafting: often clauses contain language such as "the Supplier shall have no liability for consequential and indirect losses **including** loss of profits". It has been decided that the use of the word "including" effectively characterises the exclusion of loss of profits as only those of a consequential or indirect type. The clause did not therefore exclude loss of profits which were "direct".

MUTUALITY

Applying the clauses to both parties can assist in justifying the supplier's exclusion clauses, but care must be taken not to inadvertently restrict the supplier's remedies, e.g. where mutual exclusion of liability for loss of revenue or profit could, in theory, exclude the supplier's only possible claim for damages upon a repudiation of the contract by the customer.

EMPLOYEES/SUB-CONTRACTORS

Companies, LLPs and other businesses need to be aware that the customer may make an additional claim in negligence against not only the supplier itself but also directors, members, employees or sub-contractors of the business who may have been negligent e.g. in making designs or giving advice. It is possible to expressly allow such persons to have the benefit of the limitation clauses.

INDEMNITIES

If a contract contains on the one hand, exclusions of liability in favour of the supplier and on the other, indemnities from the supplier, a supplier should consider whether all or particular exclusion clauses apply to the indemnities and if so ensure this is clear.

CONSUMERS

Businesses dealing with consumers need also to be aware of other legislative requirements that can affect their ability to limit or exclude liability, notably the Consumer Rights Act 2015 (CRA), including:

- contract terms must be transparent and “fair” or otherwise will be unenforceable under CRA where the consumer is an individual acting for purposes that are wholly or mainly outside that individual’s trade, business, craft or profession;
- a contractual term not individually negotiated will be regarded under CRA as not fair and therefore not binding on the consumer, if it causes a significant imbalance between the **parties’ rights to the detriment of the individual consumer**;
- the Consumer Protection from Unfair Trading Regulations make it a criminal offence to carry out **“unfair commercial practices”**. Including **unenforceable terms** in sales terms may amount to such a practice – so care is required.

CONCLUSION

When things go wrong, it is important to be able to rely on your exclusion clauses. When these clauses are challenged it can be extremely costly for suppliers. Although it is impossible to predict a **court’s decision in any particular case, it is clear that certainly in business to business contracts**, suppliers can reduce potential liabilities under a contract through clear, carefully drafted exclusion clauses that are not too wide or ambitious.

KEY CONTACTS

For further information about any of the issues raised in this guide, please contact:



Beverley Whittaker

Partner

T: +44 (0)1483 734281

M: +44 (0)7867 522929

E: beverley.whittaker@stevens-bolton.com

Beverley Flynn

Partner

T: +44 (0)1483 734264

M: +44 (0)7769 708486

E: beverley.flynn@stevens-bolton.com

STEVENS&BOLTON

Wey House, Farnham Road
Guildford, Surrey, GU1 4YD
Tel: +44 (0)1483 302264
Fax: +44 (0)1483 302254
DX 2423 Guildford 1
www.stevens-bolton.com

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