

THE BASICS: LIMITING AND EXCLUDING LIABILITY FOR BREACH OF CONTRACT

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When negotiating contract terms parties will very often seek to include clauses that attempt to limit or exclude damages that may be claimed if a breach of contract occurs. However, even if a clause is agreed and included in the signed contract it will not necessarily work as expected.

Some types of liability cannot be excluded - no matter what the contract says. What may appear to be a clear limitation of liability can still be challenged if there is ambiguity as to what the clause means and / or the term is deemed to be unreasonable. Steps can be taken to try to ensure limitation or exclusion of liability clauses do work and reduce any opportunity for challenge.

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Why limit liability for breach of contract?

Every contract involves some risk of liability, which may occur with or without fault or through the action of others. If there is no limit to that liability there will be no financial limit on the damages that could be recovered in the event of a breach, although there may still be legal limits on recovery under the general law of damages.

Most parties to a contract will want to limit the extent to which they could be held liable in

the event of a breach and seek to agree clauses that exclude or limit liability for certain types of losses as a result.

Excluding liability - what can you exclude?

First of all, you cannot exclude everything:

- You cannot exclude liability for your own fraud / dishonesty;
- You cannot exclude liability in negligence for death or personal injury;
- You cannot exclude liability for the supply of defective goods under the Consumer Protection Act 1987;
- You cannot exclude liability for breach of all contractual duties; you cannot leave the other party to the contract with no meaningful remedy in the event a breach of contract.

You can, however, seek to exclude or limit certain categories of damage. If the words used are clear enough you can exclude liability for negligence, misrepresentation, issues relating to quality and fitness for purpose among other things, plus types of loss within a category, such as excluding liability for consequential losses.

Excluding liability for consequential loss - what does that mean?

Consequential and indirect losses do not describe any particular kind of loss. All losses can be direct or indirect/consequential - depending on how foreseeable the particular loss was.

The courts have interpreted consequential losses as being losses that do not arise naturally, instead arising from special circumstances that the party in default was aware of when the contract was entered into. Direct losses on the other hand are categorised as losses which arise naturally from the breach of contract.

Many parties mistakenly believe that excluding liability for consequential or indirect losses will include a claim for loss of profits - if loss of profits are a direct loss, a clause excluding liability for indirect or consequential loss will be ineffective to exclude that liability.

Can you cap your liability?

Yes, and for risks that are not excluded a cap should be considered. The cap could be a

financial one and / or one which will exclude liability if a claim is not made within a certain timescale.

A financial cap on liability should state:

- the value of the cap or, if not a fixed sum, how it can be calculated (for example as a multiple of the contract's value); and
- whether the financial cap applies to all liability that might arise under a contract; to liability for a defined period; and / or to liability for each claim or series of related claims.

A 'time limited' cap could also be used to exclude one party's liability completely if a claim is not brought within a certain time scale. This is often used in common corporate transactions - providing that any warranty claim must be brought within a set period of time. If a claim is brought after the time specified it will be excluded.

Will your exclusion / limitation clause work?

Whether exclusions or limitations of liability will be effective will depend on whether the clauses in question can be interpreted clearly and whether they can be deemed to be fair and reasonable.

Under the Consumer Rights Act 2015 (CRA) a term in a consumer contract which limits or excludes liability will not be binding unless it can be said to be fair. Likewise under the Unfair Contract Terms Act 1977 (UCTA) liability can only be limited or excluded in business to business contracts if the clause is fair and reasonable.

On interpretation it has traditionally been the case that any clause seeking to limit or exclude liability will be construed so that any doubt as to its meaning will be decided against the party seeking to rely upon the clause.

In recent years however, the courts, including the Court of Appeal, have increasingly found that parties (particularly those of equal bargaining power) can agree to allocate risk as they see fit and the natural and ordinary meaning of the clause should be given effect. The traditional approach now has very limited application. Only if the wording used is truly ambiguous will the 'rule' which allows any doubt as to the effect of the clause to be construed against the party seeking to rely on it be applied.

The courts have also held that negligence does not need to be referenced specifically in the exclusion clause if the words used are wide enough to cover claims in negligence.

However, to avoid any dispute as to the meaning of a clause from arising, a clause which intends to limit or exclude liability for negligence as well as for breach of contract, should expressly say so.

What do I need to remember?

Exclusion clauses will not always be effective. However, to give your limitation or exclusion of liability clause the best chance of working - and reduce opportunity for the clause to be challenged as a consequence - consider the following:

- Ensure that clear and unambiguous wording is used - and if negligence is to be excluded, make sure the clause expressly says so;
- If the clause is ambiguous and is open to interpretation, any doubt as to its meaning may be decided against the party seeking to rely on it;
- Do not try to hide or bury exclusion or limitation clauses in a contract or standard terms - to give them the best chance of working they should be brought to the other party's attention;
- Do not exclude liability for fraud - if you do, the whole exclusion clause may fail;
- You cannot exclude liability in negligence for death and personal injury - if you try to, that part of the clause will fail;
- Check that any exclusion or limitation clauses work with any indemnity clauses. In particular, indemnity clauses will not automatically be exempt from limits on liability. Even if the exclusion / limitation of liability provisions do not apply to an indemnity, any amount claimed under it could still be counted towards an overall cap;
- Make sure that exclusion or limitation clauses are consistent with the rest of the contract;
- Excluding consequential losses will not necessarily mean that loss-of-profit claims are excluded; and
- The courts are reluctant to get involved where the parties have just made a bad bargain - there will need to be uncertainty as to what the parties agreed and / or the clause excluding or limiting liability must be unfair / unreasonable before the courts will step in.

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