

EXCLUSION CLAUSES IN AUSTRALIAN TECHNOLOGY SUPPLY CONTRACTS To exclude or limit?

Sharon Robson, Lawyer, Truman Hoyle Lawyers

INTRODUCTION

Limiting the level of liability in technology supply contracts is a well known risk management strategy. But is it preferable for an exclusion clause to exclude liability with a clause excluding consequential loss or to cap liability to a certain amount?

This paper examines the limitations of a consequential loss exclusion clause and advocates for a clause that caps liability.

AN EXCLUSION CLAUSE UNDER CONTRACT

The intention of a technology contract is to receive or supply a technology product or service. In the event that one party breaches the contract the contractual obligation gives rise to damages. Damages for breach of contract are intended to put the innocent party in the same position as if the breach had not occurred.¹ Under ordinary principles of contract law, a party is entitled to an award for losses which directly flow from the breach. These are known as direct or general damages. A party is also entitled to damages for loss which has arisen indirectly as a consequence of the breach. These losses are known as 'indirect or consequential'. But in order to claim this loss the parties must have contemplated, at the date the contract was entered into, that the loss may be evident if a breach occurs.²

Prudent organisations contract by including an agreed liability exclusion clause to protect or manage the risk of a possible breach. An exclusion clause may exclude **consequential loss**;³ and / or **cap or restrict** liability to a certain amount.⁴ Generally, the function of an exclusion clause is to provide a defence against claims for breach of contract, and / or define contractual duties and obligations.⁵ It is obviously preferable for a supplier to include a clause that caps liability as well as one that excludes consequential losses. However, in the process of vigorous negotiations of which clauses are subject to, the purchaser may not agree to both clauses being included. As such, it is important to determine which clause is preferable – a clause which excludes consequential loss or a clause which caps liability?

INTERPRETING CONSEQUENTIAL LOSS EXCLUSION CLAUSES:

A consequential loss exclusion clause seeks to exclude liability however, the clause is limited by the difficulty in:

- a) understanding the meaning of consequential losses;
- b) differentiating between various types of loss; and

¹ *Robinson v Harman* (1848) 1 Exch 850.

² *Hadley v Baxendale* (1854) 9 Ex 341, 354.

³ See eg, *L'Estrange v Graucob Ltd* [1934] 2 KB 394; *Davis v Pearce Parking Station Pty Ltd* (1954) 91 CLR 642.

⁴ See eg, *Darlington Futures Ltd v Delco Australia Pty Ltd* (1986) 161 CLR 500.

⁵ *Council of the City of Sydney v West* (1965) 114 CLR 481, 487-8, 495-6, Barwick CJ.

c) interpreting the object of a particular consequential loss exclusion clause.

1. Meaning of consequential losses

The case, *Hadley v Baxendale*,⁶ provides that indirect losses are those that may reasonably be supposed to have been in the contemplation of both parties at the date of the contract as the possible result of the breach.⁷ In *Croudace v Cawoods*⁸ the court held that ‘consequential loss’ has the same meaning as indirect loss.⁹

Consequential loss has been described as being less direct or more remote than general damages. It is loss that is a step removed from the transaction and the immediate effects of the transaction.¹⁰ This means if the claim arises directly from the breach of contract, the loss will not be covered by a consequential loss clause. In claiming for consequential loss, the other party must have been aware of, or foreseen that the loss might have been likely at the time the contract was entered into.¹¹ It must be loss that a reasonable person would have realised was likely to result or be in the contemplation of the parties to the breach.¹² The loss might be particular to the parties, or loss of a unique opportunity. Consequential losses might include loss of profits; the costs of obtaining a suitable system from elsewhere; wasted overheads; loss of business opportunity or revenue; or loss of data.

2. Differentiating between various types of loss

A party to a contract may intend that a statement which excludes ‘all indirect or consequential loss’ may exclude liability. Case law indicates that the clause however, may be held to be too broad to cover all losses that may arise as a result of the breach and as a result was not what the parties contemplated when the contract was made.

In the English case, *Pegler Ltd v Wang (UK) Ltd*,¹³ Pegler brought a claim for damages for 22.8 million pounds against Wang for failing to deliver computer hardware, software and associated services as promised under the contract. The consequential loss clause stated that the company would not be liable for any indirect or consequential loss, howsoever arising including but not limited to loss of anticipated profits in connection with or arising out of the supply, functioning or use ... The clause further indicated that Wang would not be held liable for any loss whatsoever, except as provided in the contract.

The court held that notwithstanding the word ‘including ... anticipated profits’ the exclusion clause only excluded losses which were in the contemplation of the parties at the time the contract was made and did not mean that the exclusion applied to loss of all profits. Anticipated profits were recoverable by Pegler under direct damages.

The interpretation of ‘anticipated profits’ in Pegler indicates that specifying the different heads of damage may not produce the result as the parties intended. Case law in Australia indicates that discerning between the different heads of damage is difficult as the court, as in the English cases, characterises some losses both as direct and consequential loss.

⁶ (1854) 9 Ex 341, 354.

⁷ *Hadley v Baxendale* (1854) 9 Ex 341, 354.

⁸ [1978] 8 BLR 20.

⁹ *Croudace v Cawoods* [1978] 8 BLR 20.

¹⁰ *GEC Alsthom Australia Ltd v City of Sunshine* (Federal Court, Ryan J, 20 February, 1996, unreported)

¹¹ *Croudace v Cawoods* [1978] 8 BLR 20.

¹² *Koufos v C Czarnikow Ltd* [1969] 1 AC 350 at 385.

¹³ [2000] BLR 218.

Loss of future profits and the issue of liability to a third party was discussed in *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd*.¹⁴ In this case, BHP-IT entered into a head contract with the Department of Foreign Affairs and Trade for the supply of a system and a back-to-back sub-contact with GEC Marconi. After the project failed, BHP-IT claimed against GEC for its failure to complete its obligations. Justice Finn held that the lost benefit of the head contract which included loss of future profits, project costs and BHP's liability to the Department of Foreign Affairs and Trade due to GEC's repudiation of the sub-contract were direct losses.

Although consequential loss is viewed as loss particular to the contracting parties, future profits may not be regarded as consequential loss as the value may not be ascertained at the time of contracting. In addition, although losses affecting third parties may appear remote, the loss may be directly attributable to the breach in contract and may not be excluded by a consequential loss clause.

Whilst a party might obtain the benefit of the exclusion clause if the head of damage is specified, the court may nevertheless interpret the loss as direct loss and as such the loss may not fall within the ambit of a consequential clause.

3. Interpreting consequential loss exclusion clauses.

Case law indicates that while the court's interpretation of an exclusion clause is not clearly enunciated, the court will read down an exclusion clause if it is unclear. At common law, a clause that is broad or unclear will be assessed in context with the contract as a whole.¹⁵ The court will determine the intention of the parties and assess whether the clause applies to the circumstances which give rise to liability.

If the clause is drafted ambiguously, the court using the principles of construction and the *contra proferentum rule*, will interpret the clause narrowly, limiting the scope and effectiveness of the clause against the party relying on it.¹⁶ If the main purpose of the contract is defeated by its words or if the breach is serious the court, in favour of the party that suffered the loss, may hold that the clause does not apply.¹⁷

Given the strict interpretation and the difficulty of describing the heads of damage under a consequential exclusion clause may mean a party to a breach may not necessarily avoid liability even though relying on the clause. The extent that a company is liable may be assured with a clause that caps liability.

CAPPING LIABILITY:

Consistent with giving business efficacy and ceding to the principle that business people are capable of making commercial contracts and looking after their own business interests the court will not reject a clause if it is clear.¹⁸ In *Darlington Futures Ltd v Delco Australia Pty Ltd*,¹⁹ the judges of the High Court referred to Lord Diplock in *Photo Production Ltd v Securicor Transport Ltd*,²⁰ and stated that if the 'words are clear and fairly susceptible of one

¹⁴ [2003] FCA 50.

¹⁵ *BHP Petroleum Ltd v British Steel Plc* [2000] 2 Lloyd's Rep 277, 281-282, Evans LJ.

¹⁶ *Darlington Futures Ltd v Delco Australia Pty Ltd* (1986) 161 CLR 500.

¹⁷ *Glynn v Margetson & Co* [1893] AC 351; *Suisse Atlantique Société d'Armement Maritime SA v NV Rotterdamsche Kolen Centrale* [1967] 1 AC 361, 393.

¹⁸ *Darlington Futures Ltd v Delco Australia Pty Ltd* (1986) 161 CLR 500.

¹⁹ (1986) 161 CLR 500.

²⁰ [1980] 2 WLR 283, 296, Lord Diplock.

meaning only' the court would not reject the clause even if they consider that the clause is unreasonable.

A clause capping liability is clearer than a consequential loss exclusion clause. As a result, litigation may not be required in order to decide the respective interests. In the event a dispute does arise, a clause capping liability is clear in meaning and may be interpreted strictly by the court.

Capping consequential losses

However, care must be made when drafting exclusion clause that caps liability. If a clause purports to cap 'consequential losses to the value of the contract', again the loss claimed may be held to be direct loss, rather than losses arising as consequential loss. In *British Sugar Plc v NEI Power Plant Projects Ltd*,²¹ which involved a breach of utility services under contract; the court rejected the claim that consequential loss was limited to the contractual value of 106,000 pounds. The plaintiff was allowed to claim damages in excess of 5 million pounds which included damages that flowed from the special circumstances and losses particular to the parties.

Capping to the value of the contract

It is normal in technology contracts to cap liability by reference to the value of the contract. In determining the amount of the cap it is recommended that a risk assessment be undertaken. This involves looking at the actual risk, the likelihood and costs incurred if the risk eventuates as well as determining any controls that will assist in mitigating that risk. The risk evaluation might make it evident that the cap should be a certain sum, such as two times the value of the contract, for example.

It is not advisable to cap all liabilities that arise in technology contracts as to do so would negate the contract. Heads of loss which are normally excluded from the cap include liability for disclosing confidential information, liability for infringing third party intellectual property, damage or loss to tangible property, fraud and liability for death and personal injury.²² If clearly specified, however, liability for negligence is able to be excluded.²³

Capping after exhausting other remedies

Introducing a capping clause which places conditions on its exercise is an effective way to offer a remedy but to limit liability. The contract might provide for a dollar value after exhausting the remedies that are available under insurance or from third parties; or after providing liquidated damages. Liquidated damages are those that provide sums for minimal breaches, such as payment for late delivery of the technology. A clause for liquidated damages however must not act as a penalty and must be clearly drafted. If the clause is uncertain, the clause will be deemed invalid and removed from the contract²⁴ and the clause will cease to act as a cap on contractual liability.

Binding a party to the clause

A party will be bound by the clause if they have signed the contract, unless they can show fraud or misrepresentation. Where the document is unsigned the court will determine whether the party knew of and consented to the clause by determining whether the document is

²¹ [1997] 87 BLR 42.

²² *Glebe Island Terminals Pty Ltd v Continental Seagram Pty Ltd* (1996) 40 NSWLR 206.

²³ *Bright v Sampson and Duncan Enterprises Pty Ltd* [1985] 1 NSWLR 346, 367, Mahoney J.

²⁴ *York Air Conditioning and Refrigeration (Australasia)* (1949) 80 CLR 11.

contractual,²⁵ and whether reasonable notice was given of the clause.²⁶ Knowledge of the clause may be more readily inferred if the parties have had previous dealings. If actual knowledge cannot be established the party seeking to rely on the clause must establish that they have done what was reasonably required of them to bring the clause to the attention of the other party.

STATUTORY CONTROL AGAINST EXCLUSION CLAUSES

1. Protecting consumers of technology contracts

It is important to remember that for consumer contracts, pursuant to section 68A(1)(b) of the *Trade Practices Act 1974* (Cth), the amount of the cap must not be less than the value of supplying the services again or payment of having the services supplied again. The objective of the *Trade Practices Act 1974* (Cth) is to provide protection for consumers of products and services. A consumer for the purposes of the Act is a person who purchases goods or services to the value of \$40,000.00. Where the value exceeds \$40,000.00 the person will still be considered a consumer providing the goods and services were purchased for personal, domestic or household use and consumption, and not for use in trade and commerce.²⁷

In addition, section 68(2) of the *Trade Practices Act 1974* (Cth), indicates that an exclusion clause will not apply in a consumer contract if the contract is not fair or reasonable.²⁸ In determining whether a contract is fair or reasonable, the court will have regard to factors under s68(3), namely:

“... the circumstances of the case and ...
 (a) strength of the bargaining positions ... availability of equivalent ... services and ... alternative sources of supply;
 (b) whether the buyer received an inducement to agree to the term or, ... opportunity of acquiring ... services or equivalent ... services;
 (c) whether the buyer knew or ought reasonably to have known of the existence and extent of the term (having regard, among other things, to any custom of trade and any previous course of dealing between the parties).”

The court has held that consumers do not need to rely on having services or goods replaced, if the goods are deemed of little use, or if the services cannot be replaced. In *Indico Holdings Pty Ltd v TNT Australia Pty Ltd*,²⁹ Justice Giles found that the remedies provided by TNT were of no real value to Indico and the exclusion clause was held not to apply.

2. Protecting against a company’s misleading or deceptive conduct

An exclusion clause will not apply if the party’s conduct is found to be misleading or deceptive. Section 52(1) of the *Trade Practices Act* provides:

“A corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.”

²⁵ *Causar v Browne* [1952] VLR 1 (where found ticket was found not to be contractual).

²⁶ See eg, *Thornton v Show Lane Parking Ltd* [1971] 2 QB 163.

²⁷ *Trade Practices Act 1974* (Cth), s 4B(1).

²⁸ See for eg, *Law Reform (Misrepresentation) Act 1977* (ACT) s 6; *Misrepresentation Act 1972* (SA) s 8, where an exclusion clause has no effect except to the extent that the court may allow such reliance as is fair and reasonable in the circumstances of the case.

²⁹ (SC (NSW), Giles J, no 50208/90, 2 October 1990, unreported)

Conduct, that has been found to be misleading, includes a misrepresentation which may occur if the effect of ‘any behaviour, words or conduct ... misleads the other party or creates a false impression about the existence or extent of the exemption’.³⁰ In *Curtis v Chemical Cleaning & Dyeing Co*,³¹ the exclusion clause was held not to apply as its effect was incorrectly relayed to the plaintiff. Justice Denning stated that even if the false impression is created knowingly or unwittingly the misrepresentation is sufficient to disentitle the creator of it the benefit of the exemption.

CONCLUSION

The apportionment of risk is a complex task. It involves assessing the risk and determining the best method under which to mitigate that risk. An exclusion clause is an effective risk management strategy as the clause may assist in absolving a party from liability or may define the limits of the duty.

An exclusion clause excluding consequential loss is capable of excluding liability; however the extent to which a clause is effective is driven by drafting and interpretation. Exclusion clauses must be clear in meaning and capable of interpretation without ambiguity so in the event that a dispute occurs, a strict and narrow interpretation may be avoided.

A clause that is not clear in its meaning will be interpreted narrowly. Given that the scope to which losses are defined as indirect or consequential is not clearly defined under law, it is difficult to predict how a clause mitigating against loss will be interpreted. Case law indicates that an exclusion clause may be written down if a particular head of loss is not clearly specified and some losses may be construed as direct and as such may not fall within the ambit of a consequential loss exclusion clause.

As such, a clause that caps liability is preferable to a clause that seeks to exclude indirect or consequential damages. A clause that caps liability to a certain amount is clear. As a result, the parties may not require litigation, but if litigation arises, it may be likely that the clause will be interpreted strictly by the court, particularly if the clause is clear and signed to evidence the other party’s acknowledgment of the clause.

³⁰ *Curtis v Chemical Cleaning & Dyeing Co* [1951] 1 KB 805, 808-9.

³¹ [1951] 1 KB 805, 808-9.