Limitation of Liability: A General Overview under English Law

October 3, 2022 Glenn Kangisser, Shu Shu Wong

PRACTICES Offshore Oil and Gas Dispute Resolution

Limitation of liability provisions are a key aspect of commercial contracts and are often heavily negotiated. Without such provisions, there is no financial limit on the damages a counterparty can recover. Therefore, if a party wishes to reduce its exposure, clearly drafted limitation of liability provisions will need to be included in the relevant contract.

Limitation of liability clauses – what are they and why have them?

A party negotiating a commercial contract, usually the party providing a service or goods to the other party, will typically look to include an overall financial limit on its residual liability. The rationale behind having a cap is the desire to avoid exposing itself to losses which exceed what it stands to make under the contract (if, for example, such party is unable to mitigate the risk of loss by taking on insurance) and which could even jeopardise its financial stability as a whole.

The scope and amount of the limitation of liability provisions will be a commercial issue for the negotiating parties, having regard to a number of factors such as: (a) the particular project and its location, (b) the likely duration of the contract, (c) the levels of compensation, (d) market practice and (e) the commercial bargaining power of each party.

The clause will usually be expressed to apply regardless of fault of the party benefitting from the limitation, and notwithstanding breach of contract, negligence, breach of duty (statutory or otherwise) or other failure of any nature, with specified exclusions. It is designed to shield a party from liability for amounts over and above the cap, even where the loss or damage in question might have resulted from such party's breach or default.

The cap is often described as a fixed sum, although it may also be formulated as a percentage of the total contract price.

Importance of clear wording

There is a presumption under English law that neither party to a contract intends to abandon any remedies which would otherwise be available to it at law. Clear words must be used to rebut this presumption.

For instance, a company/operator who accepts an overall limitation of liability clause from a contractor/consultant is effectively agreeing to give up its right to recover certain losses from such contractor/consultant (i.e. those which exceed the amount of the contractor limit – where it would otherwise be entitled to do so). The limitation of liability clause should therefore explicitly and unequivocally state which liabilities and obligations of the contractor/consultant are subject to the cap (or caps) and the extent of such limitation.

If the language of the limitation clause is unclear or ambiguous, there is potentially a risk that it could be interpreted narrowly against the contractor as the party seeking to rely on it (the *contra*

proferentem rule). However, in a number of recent cases, the English courts have demonstrated an increased willingness to enforce limitation (and exclusion) clauses which have been agreed between commercial parties, calling into question the ongoing relevance of the *contra proferentem* rule.

What is (and what isn't) covered by the cap?

If the parties' intent is for the limitation of liability to apply in all circumstances whatsoever, irrespective of cause and notwithstanding negligence, breach of duty or other failure of any nature, including in respect of claims arising in contract, tort or otherwise at law, this should be stated expressly.

It is generally considered best practice to expressly refer to negligence (as a form of tort) instead of seeking to rely upon general words. The parties might also consider dealing expressly with 'gross negligence' and 'wilful misconduct' (and whether to restrict either to that of senior managerial or supervisory personnel).

As to which of the party's contractual obligations will be subject to the cap, it is common for the limitation of liability clause to be described as applying to all obligations and liabilities, except for those which are expressly excluded or 'carved out'. Carve-outs are negotiated on a case-by-case basis, but may include a party's obligations under the confidentiality provisions, as well as the insurance, tax, intellectual property and anti-bribery clauses.

Some limitation of liability clauses will explicitly exclude liability for fraud or fraudulent misrepresentation; this is not strictly necessary, as such liability cannot be excluded or limited by law regardless of whether this is stated in the contract.

It is also considered best practice to place the limitation of liability in a separate, stand-alone clause, rather than burying it within another clause of the contract. This reduces the risk that the limitation clause could be interpreted as applying only to the obligations contained within the particular clause in which it is located, or that it is hidden away. It also helps to ensure that the limitation clause is given appropriate attention by the parties to avoid its exclusion.

Does the limitation of liability clause need to expressly refer to negligence?

It is common for parties to unambiguously state that an overall limitation of liability applies in the case of negligence. The use of general words, such as "any loss" or "loss howsoever caused" may not be sufficient to encompass liability for negligence.

In the interests of using clear language, we still consider it best drafting practice to explicitly contemplate that the cap provision applies in the case of negligence.

What about gross negligence and wilful misconduct?

Under English contract law, there is no distinction between negligence (sometimes referred to as 'simple negligence' or '*negligence simpliciter*') and gross negligence, therefore the term 'negligence' on its own will, unless the context requires otherwise, be interpreted to include all forms of negligence. Nonetheless, some limitation of liability clauses may expressly state that the limitation applies in the case of 'negligence in any form'. This may be done as a precautionary measure, or if the contract refers to other forms of negligence elsewhere in its provisions and a distinction therefore needs to be made.

Gross negligence

At the other end of the scale, some contracting parties may agree to explicitly exclude liability arising out of a party's 'gross negligence' (or, more specifically, the gross negligence of senior managerial or supervisory personnel of such party) from the scope of the limitation clause. If this is the case, it would be prudent to define 'gross negligence' in the contract (as well as 'senior managerial' or 'supervisory personnel', if that is the case) and tailor the definition to what the parties intend it to mean. Left undefined, it will leave scope for dispute between the parties and be open to interpretation by the courts, creating uncertainty as to a party's liability exposure under the contract.

Wilful misconduct

The same would apply where the parties have agreed that the cap should not apply in the case of a party's 'wilful misconduct'. While some guidance as to the meaning of that term under English law can be gleaned from the case law, it does not have a precise and settled meaning, and what is understood by the term will be a question of interpretation in each particular case. Negotiating an acceptable definition of 'wilful misconduct' within the contract, and limiting its application to specified senior managerial or supervisory personnel of such party, is one way of ensuring that a carve-out for wilful misconduct (however that term may be defined) will not erode the effectiveness of the overall limitation of liability clause.