The purpose of a limitation of liability clause in a contract is to seek to exclude or limit a party’s liability to the other under it. The parties to a contract should analyse carefully what their potential liabilities may be under it and assess what limitations may be appropriate. In general, a limitation of liability clause is more likely to favour the supplier than the customer.

We set out below some examples of how a party may seek to exclude or limit its liability under a contract:

• The clause may provide that one or both parties will not be responsible for certain types of loss. Limitation of liability clauses often purport to limit or exclude liability for the following types of loss:

  • Indirect loss and consequential loss: These terms mean the same thing when used in a contractual provision (and are distinct from direct loss which is loss arising naturally, in the normal course, from the breach of contract itself). Indirect or consequential loss is loss which is not direct loss but may be deemed not too remote and therefore recoverable on the basis that it was in the contemplation of the parties at the time they made the contract.

  • Punitive or exemplary damages: These are designed to punish the defendant and are available only in very limited circumstances. They are rare in tort cases and unlikely to be available for breach of contract.

• The clause may set out a financial cap on a party’s liability. There is no general rule as to what level of cap will be enforceable but it is common for parties to set a cap equivalent to the amount of the charges (or a multiple of the charges) paid or payable under the contract.

• The clause may seek to exclude certain remedies that would otherwise be available to the party that is not in breach.

Under English law, it can be uncertain whether a limitation of liability clause will be enforceable because of statutory intervention and because of established rules of interpretation. On the latter, any lack of clarity or uncertainty will be construed against the party seeking to rely on the clause and so clear drafting is key.

The Unfair Contract Terms Act 1977 ("UCTA") applies to many types of contract, including business to business contracts. Exclusions/limitations of liability will be unenforceable if they fail to satisfy the “reasonableness test”. A clause will be only be reasonable if it is “a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made.” Relevant factors in the analysis are:

• the strengths of the parties’ bargaining positions;
• whether the customer received any inducement to accept the term;
• whether the customer knew or should have known that the term was included;
• in the case of a term excluding liability if a condition is not complied with, the likelihood of compliance with that condition at the time the contract was made; and
• whether the goods were a special order.

Under UCTA, clauses which purport to limit liability for the following will be unenforceable:

• death or personal injury caused by negligence;
• lack of unencumbered title in a sale or hire purchase of goods;
• non-conformity with certain terms implied by statute.

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