

A closer look at exclusion clauses

Citing an example, STUART JORDAN* says, in the face of a failure or refusal to pay, a contractor needs to think carefully about the reasons before triggering contractual tools such as suspending works or notifying intention to terminate.

WE have recently had another reminder of the need to be clear in respect of contract provisions that seek to exclude or to limit liability. Construction contracts commonly provide that neither party may recover “consequential” or “indirect” losses from the other party’s breach of the contract.

The aim is usually to describe losses which would be recognised as consequential or indirect in English Law. That is: losses which do not arise naturally and in the normal course of events from a breach, but which were reasonably within the contemplation of the parties when they entered into the contract. So, recovery of indirect or consequential loss requires some particular knowledge or expectation, on the part of the party in breach, that this type of loss might be suffered.

In addition, parties usually want to exclude the recovery of loss of profit and revenue. One reason for doing this is that performance and delay liquidated damages are generally taken to stand in lieu of lost profit or lost revenue from under-performance and delayed completion. Nevertheless, profit and revenue losses, if they arise at all, are usually going to arise naturally and directly from the breach, that is, they are not indirect or consequential. Parties, therefore, tend to list the types of excluded losses (and almost always include profit and revenue in that list) rather than rely on these legal terms *indirect and consequential*.

We might expect that express exclusion of lost profit and revenue, would bring complete clarity and avoid any dispute, but it doesn’t always work out like that.

In a recent case, a court considered such an exclusion clause, in order to decide whether wasted expenditure was or

was not a recoverable loss. It went like this: Soteria Insurance Ltd (Soteria) engaged IBM United Kingdom Ltd (IBM) to provide an IT system and to provide services on the system for a 10-year term. Things went wrong. Soteria disputed an invoice and IBM purported to terminate the contract for Soteria’s failure to pay.

This purported termination was itself held to be a repudiatory breach of contract, and Soteria sought damages in court. Their claim included an item for wasted expenditure of £128 million (\$153.9 million) – which included £34.1million paid to IBM and other large sums paid to third parties in expectation of getting a much-improved IT system from IBM.

The contract between these parties stated: “..neither party shall be liable to the other.. for any Losses arising under and/or in connection with this Agreement.. which are indirect or consequential Losses, or for loss of profit, revenue, savings (including anticipated savings..)”

IBM argued that Soteria’s claim for wasted expenditure was excluded by this provision. The “waste” of that expenditure was because it wasn’t recouped by profit, revenue or savings from successful implementation of the contract. So, IBM argued, the claim was in fact for recovery of excluded losses (profit, revenue and savings) arising from that breach.

At first instance, the judge in the (English) Technology and Construction Court accepted IBM’s argument, on the reasoning that Soteria had indeed entered into the contract in order to achieve profit,

revenue and savings – and in consequence she awarded a much lower amount than the sum claimed. However, Soteria appealed and the Court of Appeal took a different view.

They said that the types of loss which parties had agreed to exclude (profit, revenue and savings) were all of a consequential nature and depended to an extent on speculation; whereas wasted expenditure is immediately quantifiable. Adding: “*The claims that would have compensated [Soteria] for being better off as a result of the new*

IT system were excluded; the claims to compensate them for being worse off as a result of the non-provision of the IT system were not.”

Additionally, the Court of Appeal went back to some basic principles, in looking at the ordinary and natural meaning of the exclusion clause, and they concluded that the words simply do not cover wasted expenditure. The court also repeated the need for special clarity

when excluding liability. English Law is permissive (relative to other jurisdictions) in enforcing liability exclusions, but parties need to set out clear, comprehensive, express provisions for this.

Finally, on another point also relevant to our industry: a court again found that a party’s refusal to fulfil its obligations was a repudiatory breach. As is usually the case, IBM’s refusal was in response to not getting paid, but the court did not agree that it was justified. Importantly, in this case, IBM didn’t just stop work; they purported to terminate the contract formally by notice, but that didn’t protect them from the court’s finding. So, in the face of a failure or refusal to pay, a contractor needs to think carefully about the reasons for that, before triggering contractual tools such as suspending works or notifying intention to terminate. ■



Stuart ... we need to be clear with respect to contract provisions.

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