Limitation of liability, Houdini and the Court of Appeal

Keypoints

In our last article on the *Novopay limitation of liability*,[1] we showed how limitation of liability (LOL) clauses aren't always as they seem on initial review. Now, here's a 2013 English appeal case that shows how far the courts will go to get an outcome a long way from plain words in an LOL clause. It's a case, too, that shows how important context (the matrix of facts) is to modern day contract interpretation.

The LOL clause in this case stated that "*...the Company shall have no liability whatsoever in contract, tort (including negligence) or otherwise for any loss of ... profits.*" Clear enough, and many would say that is the end of the matter for loss of profit claims, as did the judge in the decision under appeal. Yet, based on overall context, the Court of Appeal was able to conclude that there was liability for lost profits in the circumstances of the case, particularly the other terms in the contract.

It's hard for those drafting LOL clauses to predict all scenarios, and to predict how courts will interpret LOL clauses, when the approach can be quite hostile, despite all the rhetoric about plain interpretation replacing the hostile interpretation of earlier days. Clients need to know that LOL's won't always work, however well drafted.

And dispute lawyers should take a second look at LOL clauses which on their face cut out liability. They may not.

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The claim

Kudos Catering had a contract with Manchester Central Convention Complex to provide catering services. The relationship fell over. Assumed for the purposes of the case was that the customer (the Convention Complex) had refused to perform the contract. Kudos sued for lost profit. But the Convention Centre said that the LOL clause cut out its liability. The clause states:

> *"The Contractor [Kudos] hereby acknowledges and agrees that the Company shall have no liability whatsoever in contract, tort (including negligence) or otherwise for any loss of goodwill, business, revenue or profits, anticipated savings or wasted expenditure (whether reasonably foreseeable or not) or indirect or consequential loss suffered by the Contractor or any third party..."*

Manchester Central Convention Complex, sued for £1.3M by Kudos Catering

The first instance court decided that the clause was effective in stopping any loss of profit claim. That is an understandable conclusion, as the clause is crystal clear, and, however commercially unsatisfactory, the parties can agree on such things as cutting out loss of profit claims flowing from a refusal by the other party to perform a contract.

Court of Appeal

The Court of Appeal decided otherwise,[2] saying the crystal clear clause did not work in this instance, relying especially on overall context. In particular, the Court of Appeal said that, despite its wide and clear meaning, the loss of profit LOL should be limited to situations where there is a claim based on more usual breach of contract and/or under indemnity liability. It's worth following the sequence by which the court arrived at its conclusion as it is a good example of the approach, and shows why care is needed on LOL clauses, given the Houdini-like outcomes where a court considers a result different from plain words is appropriate.

The Court of Appeal's Houdini approach

The sequence is:

1. The starting point in the analysis was a statement of the standard position: "*....where language is fairly susceptible of one meaning only, that meaning must be attributed to it unless the meaning is repugnant to the contract in which case it may be necessary to ignore it*".[3]

2. There are refinements on that initial position. The court cited one of the leading modern contract interpretation decisions, *Rainy Sky*:[4]

> "*. . . The exercise of construction is essentially one unitary exercise in which the court must consider the language used and ascertain what a reasonable person, that is a person who has all the background knowledge which would have reasonably been available to the parties in the situation in which they were at the time of the contract, would have understood the parties to have meant. In doing so, the court must have regard to all the relevant surrounding circumstances. If there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense and to reject the other.*"

3. Then there is the presumption against a party abandoning remedies, said the Court of Appeal:[5]

> "*There also in my view comes into play the presumption that neither party to a contract intends to abandon any remedies for its breach arising by operation of law – see per Lord Diplock in Modern Engineering v Gilbert-Ash [1974] AC 689 at 717. Lord Diplock went on to say that clear words must be used to rebut this presumption and the judge plainly thought that the words here used were sufficiently clear for that purpose. The judge should not in my view have reached that conclusion without first examining the context.*"

4. The Court of Appeal, having outlined those principles then said:

> "*....in my view, [the judge at first instance] fell into error in thinking that the ascertainment of the meaning of apparently clear words is not itself a process of contractual construction. He failed to consider the words of the clause in their wider context.*"

5. That wider context includes:

a. The Loss of profit LOL is buried in a series of clauses dealing with indemnity and insurance. The LOL should be read in the context of the clause, 2 clauses earlier in the lengthy contract, that provided for indemnities. In that way, the LOL should be limited to claims more closely related to indemnity and insurance (and the claimant's claim here was outside that area).[6]

b. The reference to "*third party*" in the LOL clause further supported that view (this involved a detailed comparison of clauses in the contract, of the sort sometimes undertaken when the courts are endeavouring to achieve an appropriate outcome).

c. As the Court of Appeal stated:

> "*[interpreting the clause in this way is] a legitimate exercise in construing a contract consistently with business common sense and not in a manner which defeats its commercial object. It is an attempt to give effect to the presumption that parties do not lightly abandon a remedy for breach of contract afforded them by the general law*".

d. If interpreted literally, the clause would deprive the affected party of any sanction for breach of contract, reducing the contract to an unenforceable statement of intent, "*effectively devoid of contractual content*". That flouts "*business common sense*".

e. The Court said (in the judgment of Tomlinson LJ, adopted by the other judges):

> "*Had the parties intended such an exclusion of all liability for financial loss in the event of refusal or inability of the Company to perform, I would have expected them to spell that out clearly, probably in a free-standing clause rather than in a sub-clause designed in part to qualify an express and limited indemnity, and in one which moreover forms part of a series of sub-clauses dealing with the provision of indemnities and the insurance to support them.*"

Conclusion

It surely seems fair that a supplier should recover its lost profit, where the customer refuses to fulfil the contract in a way that means that the contract cannot proceed. But this interpretation exercise pushes things far from plain words. The reality is that this sort of thing will happen in judgments, as courts strive to do what they see as the right thing.

It's hard for those drafting LOL clauses to predict all scenarios, and to predict how courts will interpret LOL clauses, when the approach can be quite hostile, despite all the rhetoric about plain interpretation and not the hostile interpretation of earlier days. Clients need to know that LOL's wont' always work, however well drafted.

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1. http://www.wigleylaw.com/assets/Uploads/Novopay-limitation-of-liability-valuable-insights.pdf

2. *Kudos Catering (UK) Ltd v Manchester Central Convention Complex Ltd* [2013] EWCA Civ 38

3. *Kudos* at Para 20

4. Cited in *Kudos* at Para 21

5. *Kudos* at Para 21. Modern contract interpretation can be controversial: see for example Professor David McLauchlan and Matthew Lees, *More Construction Controversy* (2012) 29 JCL 97

6. There was discussion in the appeal judgment as to where the line should be drawn.

Wigley+Company
PO Box 10842
Level7/107 Customhouse Quay, Wellington
T +64(4) 472 3023 E info@wigleylaw.com
and in Auckland
T +64(9) 307 5957
www.wigleylaw.com