Novopay limitation of liability: valuable insights

The Novopay contract between the Ministry of Education and Talent2[1] provides a useful example of a limitation of liability (LOL) clause which is unusually favourable to the customer. But that is not readily apparent on a quick review, highlighting the importance of (a) careful drafting of clauses and (b) careful review of the LOL regime in a dispute scenario. Close review of the Novopay LOL clause indicates that, on the part of the clause reviewed below, the Ministry may be in a good position.

A major function of LOL clauses, from the supplier's perspective, is to exclude liability for consequential losses, such as loss of profit and loss of savings. Recent English cases indicate that such losses will often **not** be excluded by such clauses, contrary to the understanding of many business people and lawyers. While Australasian cases come to a different view, the English cases may still be relevant, as the Novopay LOL clause shows.

Ultimately, the parties can choose to frame their LOL clause as they want. So, any case is subject to interpretation of the particular LOL clause under review.

We'll write later this week about another example that also shows that care is needed in both drafting LOL clauses and reviewing them to see if a claim is excluded in a dispute context.

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The Novopay LOL

With the usual carve-outs,[2] the Novopay contract excludes liability for all losses, except for losses that are defined as "*Direct Damages*"

"*Direct Damages*", as referred to in that LOL clause are defined as:[3]

> any liability, loss, damage, costs or expenses suffered or incurred by a party, arising as a direct, natural or probable consequence of the act or omission complained of....

Given the way Direct Damages are defined, there may be wider liability than expected. This article explains why.

English cases

Under the English authorities,[4] many LOL clauses unexpectedly do not exclude big-ticket consequential loss items such as loss of profit, loss of benefit and so on. Those cases apply the famous 19th century case of *Hadley v Baxendale*,[5] which took a two limb approach as to remoteness of damage: that is the topic

dealing with what losses are recoverable when a contract is breached. Under *Hadley v Baxendale*, damages for breach of contract are automatically recoverable if the first limb applies (they may be recoverable if the second limb applies). The first limb applies, said the court in *Hadley v Baxendale*, to such losses "*as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself*". If we take loss of profit flowing from breach of a commercial contract, generally that is to be expected (i.e. it arises "*naturally, i.e., according to the usual course of things*", applying the description of the first limb). Therefore normal loss of profits are automatically recoverable in a damages claim where there is breach of contract. Likewise as to savings that are lost due to a breach, where loss of profit is not an issue (e.g. in the Novopay scenario).

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In typical LOL provisions, the English courts did the split between direct losses (recoverable) and consequential losses (recoverable) by applying the lens of the first limb in *Hadley v Baxendale.* Broadly, the great majority of loss incurred by customers due to breach of contract, such as loss of profit and additional expense, flows naturally from the breach, and therefore it is in the equivalent of the first limb (meaning that it is recoverable). Such loss is treated by the English courts as direct not consequential loss in LOL clauses, even though many business people and lawyers would regard loss of profit, for example, as consequential loss.

Australasian cases

The leading New Zealand case in this area did not apply the English approach, preferring instead the Australian authorities that more closely follow general commercial (and lawyers') expectations: *Oceania Furniture v Debonaire Products*.[6] Among other things, the Australasian cases concluded that it does not make sense, in interpreting LOL clauses, to use the law applicable to a different although related area: remoteness of damage.

Actual wording trumps the authorities

Novopay however is a great example of how various cases and principles are subject to the wording in each LOL clause. The parties, generally, can choose their own allocation as to LOL. The courts will usually apply modern interpretation authorities such as *Investor Compensation v Bromwich*. [7]

In Novopay, it is arguable that, as the wording in the LOL clause adopts the language of remoteness and *Hadley v Baxendale,* the English authorities would apply despite the different approach taken in Australasia. The Direct Damages definition refers to losses that are the "*direct, natural or probable consequence of the act or omission complained of*". That is the language of the first limb in *Hadley v Baxendale.* It can be argued that the parties here chose the *Hadley v Baxendale* model, putting it outside the general run of LOL clauses used by parties. Therefore what is normally regarded as consequential loss, such as lost savings, is not excluded. Good stuff for the Ministry.[8]

The words rule

We can't emphasise enough though that the words of the LOL clause in question, and context in each case, dominate the approach.

Another example

We'll write later this week about another example that also shows that care is needed in both drafting LOL clauses and reviewing them to see if a claim is excluded in a dispute context. This example will show why context is so important.

1. Redacted versions of the contract and other documents are on the Ministry of Education website: <http://tinyurl.com/mxn84dq>

2. Such as in relation to IP.

3. The section in square brackets is redacted in the publicly available documents.

4. The relevant English and Australian authorities are summarised in the *Ocean v Debonaire* case referred to below

5. 9 Ex 341

6. [2009] NZHC 1139

7. But they may strain the interpretation to get an outcome favourable to a party, as the case in our next article shows.

8. However, the Ministry may have a problem with another LOL provision which adds a total cap on liability. The amount of that cap is redacted from the publicly available documents so we don't know if it is high or low.

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