

# CONTRACTUAL LIMITATIONS ON LIABILITY – ALLOCATION OF RISKS & BENEFITS

**James Carnie, Partner, Clendon Feeney**

## INTRODUCTION

A contracting party can effectively manage its liability by incorporating a clause into an agreement that either:

- Excludes liability in situations that would otherwise constitute a breach. Such a clause defines a party's obligations and helps in assessing whether or not an actionable breach has occurred;
- Limits the amount of compensation payable by that party for breach (or related liabilities, such as negligence). Such a clause acts as a defence to a cause of action that has already accrued. Whether an exclusion clause is used to define a party's obligations or as a defence can lead to significantly different results, particularly concerning third party liability;<sup>1</sup> or
- Indemnifies the contracting party for the consequences of its liability to the other party for default, or to third parties.

In this paper, unless otherwise indicated, the term "exclusion clause" will be used to refer to all three types of clauses.

The courts have traditionally been hostile to exclusion clauses, although more recently, this approach has diminished, with the focus being on the extent of the protection and consideration of commercial realities.<sup>2</sup>

The New Zealand courts have recognised that a conscious decision between contracting parties to allocate risk should not be lightly overridden, and that freedom of contract and rational commercial practice require a more "neutral" approach to exclusion clauses.<sup>3</sup>

The principles applying to the construction of exclusion clauses do, however, retain several aspects which derive from the traditionally hostile approach to such clauses.

## PURPOSE OF EXCLUSION CLAUSES

Exclusion clauses, in conjunction with other contractual provisions (eg insurance, entire agreement and deposits) and contractual processes (eg dispute resolution), are a valid method of **allocating economic risks and benefits** between parties to a contract, without which some suppliers could not afford to do business. In other cases, the cost of service or supply would invariably increase if the supplier were faced with unlimited risk. The risks borne by customers can therefore, in some circumstances, be appropriately viewed as a trade-off for the reduced cost of the service.

In practice, however, it can be difficult to distinguish between this entirely valid approach to contracting, and the less-utilitarian consequences of simply unequal bargaining power – yet this ability to identify the requirement for an exclusion clause as part of a valid "contractual allocation of risks" has been recognised as a factor directly impacting on the courts' willingness to uphold such a clause.<sup>4</sup> In *DHL International (NZ) Ltd v Richmond Ltd*, the Court, in noting that the exclusion clause was legitimate and economic reality, said that the clause was:

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<sup>1</sup> See John Burrows, Jeremy Finn and Stephen Todd *Law of Contract in New Zealand* (2ed, LexisNexis NZ Ltd, Wellington, 2004), ch 7.

<sup>2</sup> *Ailsa Craog Fishing Co Ltd v Malvern Fishing Co Ltd* [1983] 1 WLR 964; *Mitchell (George) (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] 2 AC 803.

<sup>3</sup> See, for eg, *DHL International NZ Ltd v Richmond Ltd* [1993] 3 NZLR 10 (CA); and *Shipbuilders Ltd v Benson* [1992] 3 NZLR 549 (CA).

<sup>4</sup> For example, see *Attorney-General v Seven Electrical Ltd* (2004) 8 NZBLC, paras 66 – 69.

*...entirely consistent with the agreed allocation of risk... To read down the unqualified breadth of the exclusion clause would involve re-writing the contract and transferring to the courier what is properly a commercial risk accepted by Richmond as part of its costs of doing business.*

The Court further noted that the party relying on the exclusion clause, DHL, could not have afforded to charge just \$22.50 for a courier from New Zealand to Italy if it did not limit its liability/risk. The offeree, Richmond, contracted on these terms, and therefore accepted the risk as part of its business. Richardson J observed the terms for the transaction clearly stated an open allocation of risk and responsibility and referred to an option to insure.

In order to best address risks in a contract, it is first necessary to examine the types of risks that might arise, and consider whether there are any statutory restrictions on the ability to exclude/limit those risks. This assessment should also include:

- (i) Reputational and brand risks;
- (ii) The relative seriousness and relative probability of risks;
- (iii) The proper apportionment of risks between the parties; and
- (iv) Risk management, and in particular, the implications of a risk event occurring from the perspective of the business as an ongoing trading entity.

A careful analysis of potential risks – and the implications and management of those risks – will enable a superior contracting approach to risk management.

In most cases, the outcome of this process is an assessment that the commercial risks (particularly arising from non-performance) are unequal. This measured approach to risk allocation is an important precursor to the appropriate allocation of risks, as well as the identification of other appropriate contractual provisions eg dispute resolution processes.

## **BASIC PRINCIPLES FOR EFFECTIVE EXCLUSION CLAUSES**

Below are some important principals developed by the courts relating to the enforceability and interpretation of exclusion clauses.

*Principle One – The clause must form part of the contract between the parties.*

It is a fundamental requirement that a party seeking to rely on an exclusion clause must establish that the exclusion clause forms part of the contract.

*Incorporation by signature*

Signature by the party against whom the exclusion clause is pleaded is, in the absence of specific circumstances such as fraud or mistake, usually conclusive evidence that the clause is binding and effective: *Toll (FGGT) Pty Ltd v Alphapharm Pty Ltd* [2004] HCA 52 (see below).

*Incorporation by notice*

If the exclusion clause is not part of a signed contract, it will need to be established that reasonable notice of the clause has been given. Notice can be actual, where the contents of the exclusion clause are brought to attention of person against whom it is to be used, or constructive, where the first party has done all that is reasonably necessary to bring it to the attention of the second.

It has traditionally been recognised that a particularly onerous, unusual or far-reaching exclusion clause needs a higher degree of notice, either by express notice to the other party, or by “flagging” it with appropriate emphasis in the relevant document. Whether a particular clause is “onerous” depends on the specific circumstances, although it appears that in more recent cases – no doubt as a consequence of the increasing willingness to embrace the “commercial allocation of risks” approach – the courts have perhaps been more reluctant to find that an exclusion clause requires “flagging” in order to be effective.

The timing at which notice of the clause is given is important: no exclusion/limiting term will be effective unless brought to the attention of the other party before or when the contract is made. The basic principles of offer and acceptance apply, regardless of automation or e-commerce - although it is important to be aware of the manner in which traditional contracting requirements are being applied to e-contracting and the acceptance of on-line terms and conditions.

For example, the legal effectiveness of website terms and conditions will generally depend upon adequate prior notification to, and acceptance by, the website user. One common and legally accepted approach is where the user is not able to use the website unless they "click" a button positioned at the end of the terms and conditions, indicating that they have read, understood and accepted the terms and conditions governing access.<sup>5</sup> These agreements are often described as "clickwrap" agreements. The user should be given an opportunity to cancel the proposed website activities before or at this point.

There are a number of historical cases where an exclusion has been found to fall outside the ambit of the parties' contract and therefore of no effect, or merely just a receipt for payment or a warning.

*Principle Two – An exclusion clause will be interpreted strictly, and in the context of the whole contract.*

#### *Strict construction*

Exclusion clauses are construed strictly, and a party wishing to exclude or limit liability for the consequences of breach must use very clear words. If the terminology in an exclusion clause can be read to limit the operation of the clause to particular breaches or types of breaches, then a court will read it that way.

A clause excluding liability for a breach of a warranty will therefore not exclude liability for breach of a condition, and a clause which excludes liability for a breach of an implied contract term will not successfully exclude liability for breach of an express term. The precise choice of exclusion language, after a careful analysis of the risks that may arise in the course of the proposed transaction, is vitally important. Indemnity clauses are subject to the same rules of construction as exclusion clauses.

The courts generally look to restrict an exclusion clause in any way, particularly where there is unequal bargaining power – although this usual approach "*does not entitle the Court to reject the exclusion clause, however unreasonable the Court itself may think it is, if the words are clear and fairly susceptible of one meaning only*".<sup>6</sup>

#### *Contra proferentum*

If there is any ambiguity, the courts will interpret such ambiguous contractual terms in the manner least favourable to the party seeking to rely upon them.

#### *Exclusion of liability vs limitation of liability*

The House of Lords has determined that the rules of construction that apply when interpreting clauses that completely exclude particular heads of liability should not be applied as strictly to clauses merely placing a limit on liability.<sup>7</sup> This approach has, however, been rejected in Australia. In New Zealand, the Court of Appeal has reserved its position on this issue: see *DHL International v Richmond*.

#### *Context*

When drafting an exclusion clause, the drafter must be conscious of the type of contract and the surrounding provisions which relate to risk allocation and management, including insurance, and any

<sup>5</sup> *Rudder v Microsoft Corp* (1999) 2 CPR 4th 474 (Ont SCJ); *Specht v Netscape Communications Corp* 150 F Supp 2d 585 (SDNY 5 July 2001).

<sup>6</sup> *Photo Production Ltd v Securicor Ltd* [1980] AC 827, per Lord Diplock

<sup>7</sup> *Ailsa Craig Fishing Co Ltd v Malvern Fishing Co Ltd*, n 2.

specific remedies provided for, as these factors may well affect the interpretation of the exclusion clause. It has been recognised that:<sup>8</sup>

*It is sometimes right to take into account an obligation to insure in construing an indemnity or exception clause. That is so because that context may reveal an allocation of risks which are insurable and expected to be insured.*

The context of the contract as a whole may give grounds for limiting the meaning of an exclusion clause.

*Principle Three – Specific words are necessary to exclude particular heads of liability, and some liability cannot be excluded.*

A generally worded disclaimer will have no effect in excluding liability for negligence, unless that is the only type of liability possible – although even then, clear language should be used.

Similarly, while it is possible to exclude liability for a primary or fundamental breach of the contract, specific language is necessary to overcome a presumption of construction that an exclusion clause is not intended to apply to a fundamental breach.

It is not possible, however, to construct an exclusion clause in such a manner which deprives the contract of effect and reduces it into a mere declaration of intent – unless that is the proper construction of the document as a whole, ie, the document is not legally binding. An exclusion clause will have no effect if it wholly nullifies a positive obligation under the contract. Likewise, a conflict may cause the exclusion to be defeated upon usual laws of construction where internal conflicts arise, for eg, a general, standard-form exclusion is overridden by a specifically agreed obligation.

The courts will also not give effect to an exclusion clause that contravenes public policy (eg. clause attempting to exclude liability for fraud).

## **STATUTORY INTERVENTION**

Due to the growth of standard form contracting, and increased recognition of inequality of bargaining power between parties in some circumstances, several countries have sought to introduce legislation in recent decades, notably the Unfair Contract Terms Act 1977 (UK). Statutory intervention – both domestic and overseas – can be viewed as a significant contributor to the increased willingness of the courts to uphold exclusion clauses, particularly where part of a B-2-B transaction.

In New Zealand, several statutes address aspects of exclusion-type arrangements in contracting. These include:

### *Fair Trading Act 1986 (FTA)*

The FTA is consumer protection legislation and is not aimed at private transactions. The generally accepted view is that it is not possible to “contract out” of the duties under the FTA.<sup>9</sup> However, the Court has the power to provide discretionary relief and there is a strong argument that contractual provisions may be relevant to the exercise of the Court’s remedial discretion.

### *Contractual Remedies Act 1979 (CRA)*

The parties can, in limited circumstances, contract out of the CRA. For example, the parties can, in the contract, agree that no representations were made, or expressly provide for the consequences of misrepresentation in advance.

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<sup>8</sup> *E E Caledonia Ltd v Orbit Valve Co Europe* [1994] 1 WLR 1515, CA, per Steyn LJ. For a similar New Zealand approach, see *DHL International v Richmond*, the subpart of the judgment entitled “Consequential Loss”.

<sup>9</sup> In *Picture Perfect Ltd v Camera House Ltd* [1996] 1 NZLR 310, the Court observed at 317 that “Counsel for the defendant quite properly conceded that a claim under s 9 of the Fair Trading Act 1986 could not be excluded by contract”.

The CRA does, however, restrict the ability of parties to “contract out” of the Act (s 5), and permits the Courts to disregard certain clauses of a contract where, for example, a vendor seeks to assert that the purchaser has not relied on representations made by the vendor (s 4 – *Statements during negotiations for a contract*). However, it appears that the parties can still expressly agree to limit or even exclude the vendor’s liability for misrepresentations. Pre-contractual conduct is addressed further below.

In particular, s 4(1) limits exclusion clauses and enables the Court to go behind a clause and look at the actual circumstances leading to the making of the contract, therefore also by-passing “no reliance” and “entire contract” clauses “*unless the Court considers that it is fair and reasonable that the provision should be conclusive between the parties, having regard to all the circumstances of the case*”.

#### *Consumer Guarantees Act 1993 (CGA)*

The CGA provides certain statutory guarantees in relation to the provision of goods and services to consumers. If the CGA applies, then it cannot be contracted out of (except for business transactions, repairs and parts, and other certain exceptions), but note s 41 exceptions (ie, contracts not covered by CGA). A CGA exclusion clause is, therefore, now standard in B-2-B supply agreements (see s 43(2) CGA).

#### *Hire Purchase Act 1971*

The Hire Purchase Act contains provisions similar to the CGA, which are designed to protect purchasers of goods under hire purchase (eg, implied fitness for purpose of goods, title, quality compliance with description and sample). A clause in a hire purchase agreement purporting to contract out is generally ineffective (s 51).

Although the Hire Purchase Act has now been repealed by Credit Contracts & Consumer Finance Act 2003, the Act may still be applicable in respect of hire purchase agreements entered into before 13 Oct 2003.

#### *Door to Door Sales Act 1967*

An agreement to which this Act applies must meet certain formalities, and is subject to a right of cancellation by purchaser. These provisions have effect despite any contrary provision in a contract (s 12).

#### *Insurance Law Reform Act 1977*

The Act restricts the ability of an insurer to rely upon an exclusion clause to deny cover, notably by reason of misstatements (unless material and substantially incorrect) or lack of causal connection between an excluded circumstance and the loss suffered.

#### *Dispute Tribunal Act 1988*

A tribunal can decline to give effect to a provision in the agreement that excludes or purports to limit conditions or warranties, or exclude or limit liability, in pursuit of the “*justice of the case*”.

### **DRAFTING EXCLUSION CLAUSES**

There are several issues to be considered before commencing the process of drafting exclusion and other risk apportionment and risk management provisions in a contract:

1. What **type** of contract is this? What laws apply?
2. What are the key **benefits/rights** being exchanged under the contract? What are the risks to receiving the benefits due to your client?
3. What are each party’s **obligations**? What are the risks/potential causes of non-compliance by your client? By the other side? If non-compliance occurs, what are the implications for your client?
4. What are the **potential uses** for this contract (ie. one-off or standard form – if the latter, see standard form contacting below)?

5. How should risks that eventuate be **managed**? What process should apply? Care should be taken to ensure that a remedy is provided that is both commercial and practical. For example, if a defect might arise in the course of supplying goods or services, when would that defect become known to the parties? How would it be discovered? In those circumstances, what is the appropriate process to follow? It may be that defects in a supply of a source material could be discovered at different times during the supply/manufacture/wholesale/retail continuum. Depending upon the timing and nature of the defect, different processes and remedies might well be appropriate.
6. Which **parties** (including third parties) should be covered by the risk apportionment provisions? See third party liability below.
7. What is the appropriate liability **cap**, if any? Should a cap/limitation be inserted in addition to an exclusion clause in order to provide a further layer of protection?
8. How does the clause sit with **other provisions** in the contract? See principles two and three above. Consistency with indemnities and insurance provisions is particularly important, although consider also force majeure, entire agreement, no reliance and assignment clauses.
9. Should the claims process include a reduced claims period?

Having considered these issues in the particular circumstances – and bearing in mind the relevant principles applying to exclusion clauses – proceed. As a final observation on this issue, any contents of a contract which provide indicia of the deliberate commercial allocation of benefits and risks between the parties are generally a useful addition.

For example, it is not possible to contract out of the FTA, although if the Court considered that both parties were advised and had specifically considered and accepted the risk allocation when contracting, the Court may be reluctant to exercise its statutory discretion to award compensation to overturn those contractual arrangements. Similarly, the surrounding contractual provisions may assist a finding that:

- (a) Any alleged misleading conduct did not induce the other party to enter into the contract;
- (b) The Court should refuse to disturb the contractual arrangements as provided in the final paragraph of s 4(1) CRA; or
- (c) The “conduct” in question, including the risk/liability allocation, was, from an overall perspective, not misleading or deceptive (see *Butcher v Lachlan Elder Realty Pty Ltd [2004] HCA 60*).

## STANDARD FORM CONTRACTS

Problems have historically arisen where exclusion clauses are incorporated into standard form contracts. Because these contracts are commonly prepared by the party in the superior bargaining position, exclusion clauses are applied between business and private person with no genuine bargaining. Standard form contracts are sometimes called “contracts of adhesion” because the party in the inferior position must adhere to superior party in order to contract.

With little or no room for negotiation in these contracts, it was often the case that injustices arose because of the exclusion clauses written into such contracts, particularly from the perspective of the private consumer. The legislative intervention described earlier was a direct consequence of these concerns.

Against the current legislative setting, and with the more neutral approach to exclusion clauses by the courts, standard form contracting is more accepted and, subject to compliance with the statutory regime, judicial intervention is probably less likely. Issues arising from a standard-form approach include:

- The need to ensure that specific contractual arrangements do not clash with and/or override the general standard terms, and otherwise satisfy the basic principles applying to exclusion clauses;
- Ensuring that standard terms become part of the contract between the parties, focussing in particular on the transacting/business process to be implemented by the client; and

- Ensuring that the language adopted satisfies the rigorous standards applied when construing exclusion clauses, and covers all losses arising from transactions in which the standard form contract may be used, yet without introducing undue complexity or length to the contract.

It is often inappropriate to completely exclude the liability of one party under a standard form contract – there may be adverse marketing implications from doing so, and the nature of the contract may warrant a more balanced approach. Standard terms adopted by members of industry-specific organisations are good examples of endeavouring to strike the right “balance” between the interests of all involved, while still providing substantial protection to the suppliers (see, for eg, attached clause for RINA).

## PRE-CONTRACTUAL CONDUCT

Appropriate exclusion clauses can manage risk arising from pre-contractual conduct, and in particular, subsequent assertions of misrepresentation, or misleading and deceptive conduct. A primary role for a lawyer in the contract drafting process is to isolate, examine (if possible) and manage this risk in the contract. This, of course, is easier said than done, particularly where pre-contract negotiations are well advanced before the client seeks their legal advisor’s assistance. It is very risky to commence preparing a contract without knowledge as to the course of dealings leading up to that point. A detailed briefing should be sought from the client.

The relevant laws are primarily the Contractual Remedies Act (s 4) and Fair Trading Act (s 9).

### *Contractual Remedies Act (CRA)*

The CRA (as described above) provides for damages if a misrepresentation is established (s 6), regardless of any exclusion clause relating to “breach of contract” or similar. Section 7 provides cancellation rights also, and the Court has considerable discretion under s 9 to grant relief following cancellation. However, ss 6 – 10 are all subject to s 5, which provides:

#### **5. Remedy provided in contract—**

*If a contract expressly provides for a remedy in respect of misrepresentation or repudiation or breach of contract or makes express provision for any of the other matters to which sections 6 to 10 of this Act relate, those sections shall have effect subject to that provision.*

It is important to note that s 5 does not entail an examination of the **adequacy** of the remedy provided. The parties are therefore free to:

- (i) Expressly provide for a remedy in damages for misrepresentation and exclude the remedy of cancellation (or vice versa);
- (ii) Limit or prescribe a process for either or both remedies; or
- (iii) Expressly exclude a remedy altogether.<sup>10</sup>

If there is a risk that a misrepresentation may have occurred (or at least, may be alleged subsequently), then the available remedies for pre-contractual misrepresentation should be expressly and clearly excluded or limited in the contract.

Even where misrepresentation is not expressly excluded, the Courts have indicated that they will not lightly override a “no reliance” or “entire agreement” clause in the absence of an imbalance in bargaining power.

The Court of Appeal in *Brownlie v Shotover Mining Ltd*<sup>11</sup> confirmed that in B-2-B transactions negotiated at arms length, the parties are entitled to achieve contractual certainty concerning pre-contract representations unless there is fraud by one party.

<sup>10</sup> *McKenzie Institute International v Accident Rehabilitation and Compensation Insurance Corp CA* 228/97 (16 December 1997).

<sup>11</sup> CA 187/87.

Similarly in *Herbison v Papukura Video Ltd*,<sup>12</sup> a disclaimer in respect of representations made prior to the sale of video business was held to be conclusive between the parties. Henry J based this decision on 5 factors, including:

1. No disparity between the bargaining powers of the parties;
2. Both parties in receipt of competent legal / accounting advice; and
3. The precise wording of the relevant provisions including the disclaimer was the subject of detailed negotiations.

#### *Fair Trading Act (FTA)*

Unlike the CRA, there is no potential to contract out of the FTA. However, like the CRA, it is possible to influence the exercise of the Court's discretion (for or against) interference with the contractual allocation of risks by careful drafting, or even to provide strong evidence of reliance (or a lack of) or similar essential components of (or barriers to) an FTA claim against the client.

### **THIRD PARTY LIABILITY**

It is sometimes appropriate to extend an exclusion clause to one or more third parties. However, it is impossible to exclude the liability of the contracting parties to third parties who are not party to the contract. The risk of liability to that third party may, at best, be allocated between the contracting parties.

It is possible, however, to extend the benefit of a contractual exclusion to a third party. The laws of both contract and tort apply in that situation.

#### *Contract law*

In contract law, protection may be extended to a third party by one of two methods:

- At common law, by using a "Himalaya" Clause; or
- Under statute law, by including a clause satisfying the requirements of the Contracts (Privity) Act 1982 (s 4).

In respect of the first method, the lack of privity may be overcome if the exclusion clause is worded so as to create a separate contract between the plaintiff and the third party by agency. As a minimum, the following needs to be satisfied:

- (i) The contract must clearly intend to protect the third party under the exclusion clause;
- (ii) It must similarly be clear that one party, in addition to contracting on their own behalf, is contracting as agent for the third party;
- (iii) The contracting party has authority to act as agent for the third party (later ratification may suffice); and
- (iv) The third party must give consideration to the other contracting party.

The Contracts (Privity) Act is a simpler route, without the need to establish agency or independent consideration. The two methods are mutually exclusive, since a Himalaya Clause will have the effect of creating a contract with the third party, whereas the Contracts (Privity) Act can only apply in the absence of a contract with the third party.

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<sup>12</sup> [1987] 2 NZLR 527. Compare to *M E Torbett Ltd v Keirlor Motels Ltd* (1984) 1 NZBLC 102,079.

## Tort

In tort, a third party's potential liability to the contracting parties can (in appropriate circumstances) be relieved by the defence of *volenti non fit injuria* (voluntary assumption of risk) or by the rule which allows a defendant to modify or exclude tortious liability by the use of a non-contractual notice.

Despite the ability of third parties to deny liability through tort, a more certain result might well be possible by implementing one of the two recognised contractual methods of excluding third party liability.

## RECENT CASE LAW

The following is a selection of recent cases that illustrate the principles discussed above.

### ***Attorney-General v Seven Electrical Ltd (2004) 8 NZBLC 101,501***

Seven contracted with the Crown to supply and install a UPS (uninterruptible power supply) for the National Library's computer system. The UPS included a bank of 64 12v 40-amp batteries that Seven purchased from MHS, which in turn had purchased them from the New Zealand importer, CYB.

Just three days after installation, a battery in the UPS exploded and \$1.9m damage occurred from the ensuing fire at the National Library. The Crown sued Seven in contract and MHS in negligence, and MHS joined CYB alleging breaches of the contract between them. The High Court hearing in question examined only whether CYB's contractual terms were sufficient in excluding liability for the deficient battery and therefore operating as a complete defence to the claim by MHS against it.

CYB's contract terms were printed on the reverse of its invoice. Therefore, from a timing perspective, the invoice itself failed to form part of the contract formed when offer and acceptance had been completed earlier.

It was held, however, that the exclusion clause was incorporated into the contract in question by virtue of the prior course of dealing between the parties, and that the clause was not so onerous as to otherwise require express "flagging", due to several circumstances including:

- The clause was relatively common between importers and distributors;
- Eight prior sales on the same terms between the parties in the preceding eleven months;
- No evidence of MHS doing other than accepting the terms; and
- Other clauses re-enforced the application of the contract terms to orders, and these other clauses were not unusual or onerous.

The Court undertook a comprehensive analysis of case law concerning onerous or unusual clauses requiring "flagging" and recorded its "*strong impression*" in this case that:<sup>13</sup>

*[A] term whereby a supplier of goods excludes its liability for consequential loss is by no means uncommon in commerce... [and]*

*Condition 5 [the exclusion clause] was not onerous or unusual. If that is correct, then in my view the reasonable notice requirement was satisfied here by a broad margin. If that is wrong, and Condition 5 is more accurately categorised as onerous and/or unusual, then I consider the reasonable notice requirement was still met for the reasons set out [as above].*

It is notable that, despite these "strong impressions", the Court still recorded that this was not a clear-cut case: see [57]. It could certainly be argued that CYB was fortunate. This case also illustrates the connection between the degree of "unusualness" of an exclusion clause, and the notice required in the absence of a signed contract.

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<sup>13</sup> At [41] and [58].

It has previously been recognised, both in New Zealand and overseas, that standard terms may form part of a contract between two parties if part of normal business practice between them.

***Toll (FGGT) Pty Ltd v Alphapharm Pty Ltd [2004] HCA 52***

Alphapharm sued Toll seeking compensation for damage caused to goods transported by Toll. The manager of Alphapharm's agent company signed Toll's application for credit, which included an exclusion of liability clause on the reverse:

*Notwithstanding any other clause of this Contract...under no circumstances shall the Carrier be responsible to the Customer for an injurious act or default of the Carrier, nor, in any event shall the Carrier be held responsible for any loss, injury or damage suffered by the Customer...*

At both first instance and on appeal to the Supreme Court of NSW, it was held that it was necessary for Toll to prove that it had given Alphapharm's agent notice of the exclusion term on the reverse of the application, and that what Toll had done was insufficient to establish that notice had been given.

The High Court of Australia rejected this approach and distinguished between the "railway passenger and cloak room ticket cases", in which a document is given by one party to the other without need for signature, and circumstances in which signature is obtained. In the latter situation, the Court re-affirmed that a signing party would be subsequently unable to deny the contract unless one of a small number of recognised exceptions applied (eg fraud, misrepresentation, mistake etc – see *L'Estrange v Graucob* [1934] 2 KB 394). None of those exceptions existed in this case.

From a basic contractual perspective, Toll had provided sufficient notice of its terms by requiring the party to sign the document immediately below a written request that the party reads the conditions on the reverse before signing.

In the circumstances, no further notice was required, and the agent's negligence in failing to read the terms did not alter this. The exclusion was upheld.

Toll therefore reflects the more neutral, less hostile approach to exclusion clauses evident in *DHL International NZ Limited v Richmond Limited*, although it is probably worth noting that both cases involved international delivery services, and considerable importance is placed (both in these cases and other judgments) on industry practice when construing exclusion clauses.

Note too the impact of s 6 Contractual Remedies Act, insofar as misrepresentation is concerned.

***Rolls-Royce NZ Ltd v Carter Holt Harvey Ltd [2005] 1 NZLR 324 (CA)***

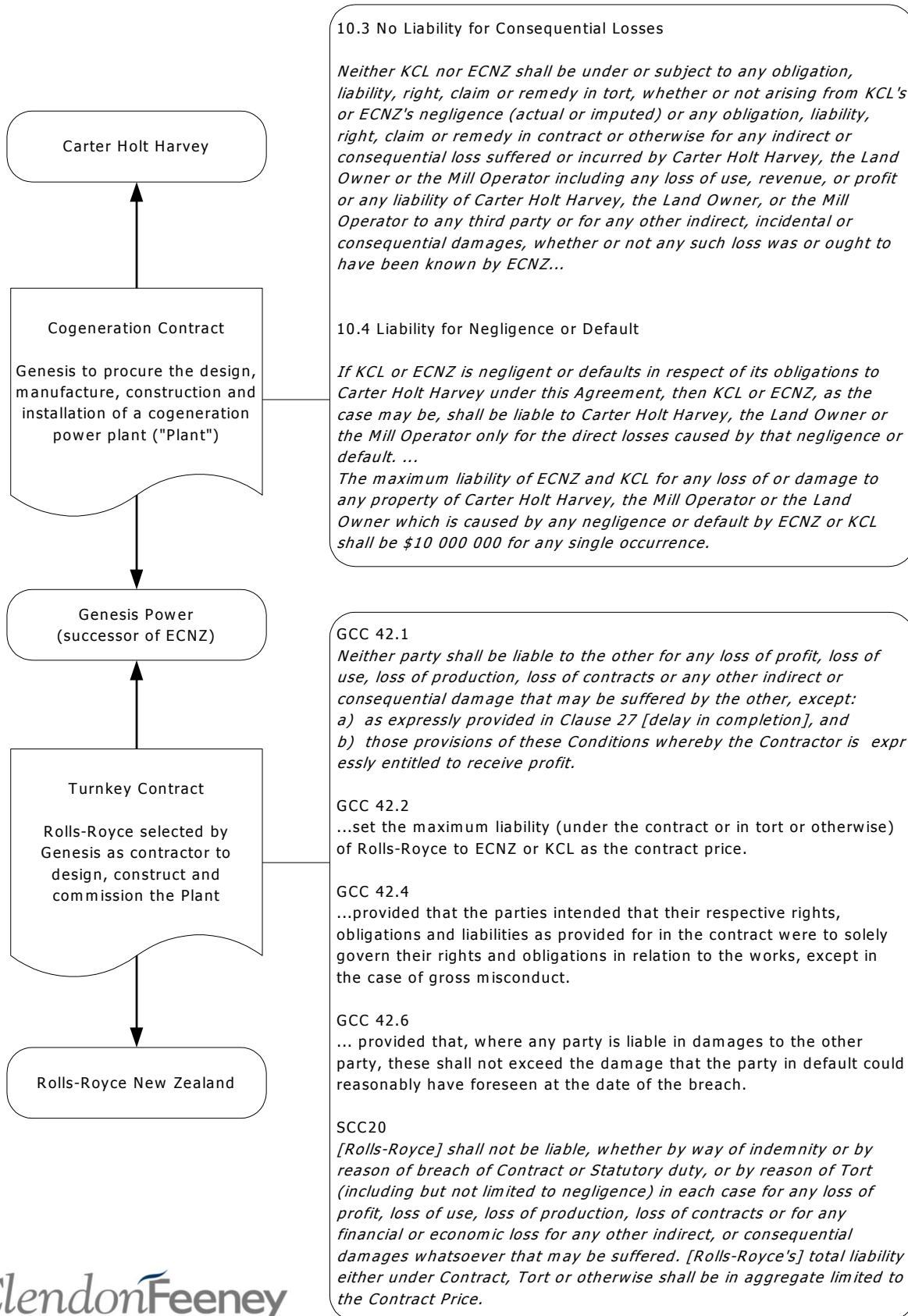
The diagram on the next page illustrates the chain of contracts adopted by the three parties involved. The objective was the design, construction and installation of a co-generation power plant which would be fuelled by wood-waste generated by CHH's operations. CHH claimed the plant was defective and sued Genesis in contract and Genesis' subcontractor, Rolls-Royce, in negligence.

Perhaps the most notable finding was that, on the facts, Rolls Royce owed no duty of care (in negligence) to CHH, due to the contract structure and other relevant considerations bearing on proximity and policy. A claim of negligent misstatement (Hedley Byrne) arising from pre-contract advice was not struck out however.

In respect of the third party liability of Rolls Royce, the Court of Appeal found that it did not have jurisdiction to disturb the preliminary High Court ruling that Rolls Royce was not liable for any "indirect or consequential losses as described by the contracts" [131].

The High Court had earlier determined that SCC 20 in the Turnkey Contract constituted **non-contractual notice** to CHH, therefore limiting Rolls-Royce's liability to CHH for claims in tort. A key factor was that, under the Cogeneration contract, CHH reserved the contractual right to review and "approve" the subcontract with Rolls Royce before executed.

Setting aside the third party exclusion issue discussed above, a discrete dispute emerged between CHH and Genesis as to the proper interpretation of clauses 10.3 and 10.4 of the Cogeneration Contract, and in particular, whether these clauses excluded CHH's recovery of losses from the cost of purchasing alternative power (ie. due to the non-performance of the cogeneration power plant), lost productivity, and increased operational and environmental costs resulting from the plant defects. In the light of the High Court's preliminary finding in relation to indirect and consequential losses, Genesis sought to strike out these claims against it by CHH.



Genesis claimed that Clauses 10.3 and 10.4 limit Genesis' liability to CHH to direct losses and exclude liability for indirect or consequential losses.

In identifying the dividing line between "direct" and "indirect or consequential" losses, Genesis identified the UK position which follows the boundary between the first and second limbs established in *Hadley v Baxendale*<sup>14</sup>: The first limb encompassing damages which flow directly and naturally in the ordinary course of things from the breach, and the second limb based upon other damages flowing from special or exceptional circumstances and are only recoverable if the defendant had actual knowledge of the special circumstances. Genesis contended:

- (a) New Zealand should not follow the UK approach, and the relevant words should be given their natural and plain meaning;
- (b) Even if the UK approach were followed, Clause 10.3 specifically excludes loss of use, loss of profit, loss of revenue, and third party liability.

In response, CHH argued:

- (a) The interpretation of clause 10.3 advanced by Genesis created tension between 10.3 and 10.4;
- (b) The UK approach was well established in the UK and should be adopted, as it had been in Australia;
- (c) Even if Genesis' interpretation was correct, striking out was inappropriate because a factual analysis would be required for each alleged head of loss to determine its appropriate categorisation; and
- (d) With reference to the specific language in clause 10.3, the "loss of use, revenue or profit..." was an express subset of "any indirect or consequential loss", meaning that it is only where the loss of use, revenue or profit etc was indirect or consequential that it was excluded under clause 10.3.

Ultimately, the Court decided that full evidence was required to establish the correct interpretation of the clause, to enable the Court to determine which categories of damage fell inside/outside the Clause. The strike out application was refused.

It appears to be the current position (without certainty) that "indirect" losses will not include lost profits that flow directly from the breach. This area of law is however not settled. This is very important when preparing limitation clauses. Many clauses currently in circulation could suffer from the same deficiency argued by CHH in point (d) above.

For the avoidance of doubt when drafting:

- Clearly define what damages are recoverable, and exclude all else; and
- Avoid all reference to "direct" and "indirect", instead focussing on the specific heads of loss in detail.

### ***Price Waterhouse (A Firm) v University of Keele [2004] EWCA Civ 583***

PWC was engaged by the University to establish a profit related pay scheme for employees. The scheme failed and PWC accepted that their advice had been negligent. The key arguments before the English Court of Appeal focussed on the interpretation of the limitation of liability clause, which included:

*"In no circumstances shall any liability (whether arising in contract, negligence or otherwise) of Price Waterhouse, its partners or employees, relating to Services provided in connection with the engagement set out in this letter (or any variation or addition thereto) exceed £1,700,000 being twice the anticipated saving to Keele University from the implementation of the Profit-Related Pay Scheme.*

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<sup>14</sup> (1854) 9 Exch 341, 354

*Subject to the preceding paragraph we accept liability to pay damages in respect of loss or damage suffered by you as a direct result of our providing the Services.*

All **other** liability is expressly excluded, in particular consequential loss, failure to realise anticipated savings or benefits and a failure to obtain registration of the scheme." (emphasis added)

PWC asserted that the second paragraph excluded anticipated savings or benefits, because these were treated (for the purposes of the contract) as indirect loss. To the contrary, the University asserted that the second paragraph defined the accepted liability, and the third paragraph merely excluded "other" liability than that covered by the second paragraph – meaning that anticipated savings or benefits (as direct losses – *Hadley v Baxendale*) were recoverable.

The Court considered competing arguments in the context of the principles applying to exclusion clauses (as discussed earlier), and determined that:

- (i) The lower Court had been incorrect in finding the second and third paragraphs above in conflict, and invoking the rule of *contra proferentem*: the clauses were not in conflict, and the language has a clear meaning, leaving no place for *contra proferentem*.
- (ii) Instead, the proper approach was to read these two sentences together, in the context of the contract, and identify whether they could be reconciled: they could, so this interpretation should be preferred.
- (iii) The word "other" in the third paragraph above was "the key to the true interpretation of the second and third paragraphs" [23 - 24] The second paragraph has precedence, with the third paragraph constituting the residual category of liability in the light of the second paragraph.
- (iv) The Court also noted that "it is a significant point that the cap is fixed at twice the anticipated saving to the University from implementation of the PRP scheme. There would be no point in fixing a cap on this basis unless it was thought that in some circumstances the University would be entitled to recover the anticipated benefit." [25]
- (v) Loss and damage is excluded by the third paragraph only if it represents loss not covered by the second paragraph.

Accordingly, the University was entitled to recover its anticipated savings or benefits up to the cap established.

### ***Zurich Australian Insurance Ltd v Regal Pearl Pty Ltd [2006] NSWCA 328***

Regal Pearl conducted a restaurant and a number of customers became ill when they consumed prawns served at the restaurant. Regal Pearl had purchased the prawns from a wholesaler, which possessed an insurance policy with Zurich Australian Insurance (ZAI).

Regal Pearl commenced proceedings in negligence and contract against the wholesaler. ZAI denied liability under the policy, and the wholesaler conducted the proceedings on its own account. Ultimately, the wholesaler was held liable for breach of the implied conditions of merchantable quality and fitness under the Sale of Goods Act 1923 (NSW) but was unable to meet judgment. Regal Pearl then commenced proceedings against ZAI for recovery of the judgment debt.

ZAI relied, among other things, on an exclusion clause under the policy. The Court held in favour of Regal Pearl, and, in construing the exclusion clause, noted that the commercial purpose of providing cover against risks in a product liability policy should, absent clear words to the contrary, be understood to encompass the range of obligations normally associated with such liability in Australian law, including implied terms of merchantable quality and fitness. No such clear words to the contrary appeared in the policy.

This illustrates the principle that to avoid specific grounds of liability, this must be clearly stated in the exclusion clause if a party is to successfully invoke the clause.

***Rich v CGU Insurance Ltd* [2005] HCA 16**

Rich and Silberman took up directors' and officers' liability insurance policy with CGU Insurance, under which there were exclusions for losses arising from dishonest, fraudulent or malicious conduct. The exclusion was engaged only where the conduct was established to have occurred following final adjudication adverse to the insured.

Proceedings were instituted against Rich, Silberman and another involving questions of breach of duty as company directors. They claimed against CGU Insurance for advance payment of defence costs under the policy, but CGU Insurance purported to deny liability relying on exclusion under the policy.

The High Court held in favour of the plaintiffs and, in construing an ambiguity in the exclusion clause, gave weight to factors such as the commercial object of the agreement, the operation of the document read as a whole and the purposive approach used by the courts to ascertain the meaning of contested language.

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This paper was prepared with the assistance of Terence Lau, Solicitor, Clendon Feeney.

This paper is intended to be a summary of the relevant issues and recent developments and does not constitute legal advice. Specialist legal advice should be sought in relation to the issues described in this paper.

## EXAMPLE EXCLUSION CLAUSES

The following are not model clauses, but examples of different approaches to the exclusion or limitation of liability in different circumstances:

### Standard Terms within a particular industry

*Royal Institute of Naval Architects (NZ) Standard Terms 2003:*

*Except as provided for by the Consumer Guarantees Act 1993 for any work for a consumer as defined in that Act, if the MARINE DESIGNER or any sub-consultant shall be found liable to the **Client** (whether under the express or implied terms of this license, in negligence, or otherwise at common law) for any costs, loss or damage suffered by the **Client**, however caused and of whatever nature, arising out of or connected with the performance or failure of performance of **Services** by the MARINE DESIGNER or any sub-consultant, then the maximum amount of that liability for all such claims against the MARINE DESIGNER and any sub-consultant shall not exceed the full value of the payment(s) made by the **Client** under the agreement between the parties.*

### Standard terms of Application and Hosting Services provider

#### 1 Warranties and Liability

##### 1.1 Exclusion of Warranties

*You acknowledge that to the fullest extent permissible by law:*

- (a) the Applications, Site, Our Materials, the Service and all related materials, features, components and programs available through the Site are provided on an "as is" and "as available" basis.*
- (b) we are not responsible for any loss of integrity, or destruction, of Your Data or Materials.*
- (c) any condition or warranty (statutory, express or implied) that would otherwise be implied in this agreement is excluded to the maximum extent permitted by the law, including, without limitation, the implied warranties of merchantability and fitness for purpose.*
- (d) where a condition or warranty cannot legally be excluded the liability if we breach that condition or warranty shall be limited, if permitted by law, to one or more of:
 
  - (i) The supplying of the Services again; or*
  - (ii) The payment of the cost of having the Services supplied again.**

##### 1.2 Limitation of Liability

*Under no circumstances shall either Party be liable:*

- (a) for any loss of profits or savings or indirect or consequential loss or damage, however caused, arising out of or in connection with this agreement and*
- (b) under any circumstances for more than the total amount of the charges paid in the 12 months before any incident (or in case of a series of incidents arising from a common cause immediately preceding the first of such incidents) giving rise to a claim.*

*No action arising out of this agreement, regardless of form, may be brought by any Party more than two years after the cause of action arose.*

### 1.3 Indemnity

*Notwithstanding Clause 1.2, you agree to indemnify us against any costs, losses, claims, or damages (including legal fees and disbursements on a solicitor and own client basis) incurred or suffered us as a consequence of:*

- (a) Your default or failure to perform your obligations under this agreement;*
- (b) Any act of omission for which you are responsible at law;*
- (c) Non-payment of charges when they become due;*
- (d) Your use of the Site or any of Our Materials; or*
- (e) As provided in Clause [Your Warranties] above.*

### **Terms governing access to bulletin-board/trade type website service**

- 10.1 You expressly understand and agree that your use of the Service is at your sole risk. The Website and the Service are provided on an "as is" and "as available" basis.*
- 10.2 We will use our reasonable endeavours to ensure the availability of the Website, subject to any downtime required for maintenance. However, we take no responsibility for any system unavailability, or for any loss that is incurred as a result of website being unavailable.*
- 10.3 We accept no responsibility for your inability to access this Website. We will use our best efforts to keep the Website free from viruses and errors. However, we do not accept liability for any damage or loss caused to your computer hardware, software, internet connections or other peripherals as a result of the use of our Website.*
- 10.4 We assume no responsibility for the corruption of any data or information held by us. You agree to maintain backups or copies of any data or information uploaded to enable efficient restoration if required.*

### 11. Indemnity

- 11.1 You agree to release, indemnify and keep us, our officers, subsidiaries, affiliates, successors, assigns, directors, officers, agents, service providers, suppliers and employees indemnified from and against all actions, claims, costs (including legal costs and expenses on a solicitor and client basis) losses, proceedings, damages, liabilities, or demands suffered or incurred to any Person arising out of or in connection with your failure to comply with these terms and conditions or arising out of any Content you post, transmit or make available through the Service.*

### 12. Disclaimer

- 12.1 You acknowledge that all information provided by us in the Service is provided in good faith. You accept that any information provided by us is general information and is not in the nature of advice. We derive our information from sources which we believe to be accurate and up to date as at the date of publication and we reserve the right to update this information at any time;*
- 12.2 We do not make any representations or warranties that the information we provide in the Service is reliable, accurate, or complete. We are not liable for any loss resulting from any action taken or reliance made by you on any information or material posted by us. You should make your own inquiries and seek independent advice from the relevant industry professionals before acting or relying on any information or material which appears in the Service.*
- 12.3 We do not warrant that any Content you submit to the Website will be protected against loss, misuse or alteration by third parties. We do not warrant that we will post your Content on the Website. If we post the Content on the Website, we do not warrant that the Content you submit will be posted within a certain time.*
- 12.4 We do not accept responsibility for any loss damage, however caused (including negligence), which you may directly or indirectly suffer in connection with your use of the Website or any linked website, nor do we accept any responsibility for any such loss arising out of your use of or reliance on information contained on or accessed through this Website.*

- 12.5 *We do not act as agent for Persons using the Service and do not participate in subsequent communications between users. We give no undertakings, representations or warranties in relation to postings on the website.*
- 12.6 *If you download any material from the Website, you acknowledge that we are not liable to you for any loss or damage, however caused, arising from the downloading or subsequent use of the downloaded material. You shall not adapt, reproduce, store, distribute, transmit, print, display, publish or create derivative works from any downloaded material. In addition, you shall not commercialise any information, products, or the Service from the downloaded material.*
13. *Limitation of Liability*
- 13.1 *To the extent permitted by law, any condition or warranty which would otherwise be implied into these terms and conditions is hereby excluded. Where legislation implies any condition or warranty, and that legislation prohibits us from excluding or modifying the application of, or our liability under, any such condition or warranty, that condition or warranty will be deemed included.*
- 13.2 *In all cases, our liability to you will be limited for all damages, losses, costs and expenses under whatever causes of action, whether in contract, tort (including negligence) or otherwise, to the costs of: (a) supplying of the Services again or (b) payment of the cost of having the Services supplied again.*

### **Business Sale and Purchase (quite transaction-specific and extensive)**

#### **1.1 No Warranty Unless Expressly Included**

- (a) *Save as and to only the extent set forth in this clause, Vendor makes no representations or warranties in respect of any matter or thing and disclaims all liability and responsibility for any representation, warranty, statement, opinion, information or advice made or communicated (orally or in writing (including, without restriction, electronically)) to any person including Purchaser, its Affiliates or any officer, stockholder, director, employee, agent, consultant, counsel or adviser of Purchaser or its Affiliates (including, without limiting the generality of the foregoing, any representation, warranty, statement, opinion, information or advice made and communicated to Purchaser by any officer, stockholder, director, employee, agent, consultant, counsel or adviser of Vendor) and Purchaser acknowledges and affirms that it has not relied upon any such representation, warranty, statement, opinion, information or advice in entering into or carrying out the transactions contemplated by this Agreement.*
- (b) *Purchaser acknowledges and affirms that it has made its own independent investigation, analysis and evaluation, economic valuations, assessment of tax matters, legal and contractual rights, obligations and liabilities and prospects for the Company and acknowledges and affirms, that in making the decision to purchase the Shares, it has relied to that extent upon its independent investigation and those of its representatives, including professional, legal, tax, financial, business and other advisers. Vendor however acknowledges that Purchaser has relied on the warranties and representatives set out in this Agreement.*
- (c) *Purchaser acknowledges that it has actual or constructive knowledge of the subject matter of the warranties and therefore any breach of warranty shall not be enforceable against Vendor to the extent that it is shown that the inaccuracy, error or omission underlying the alleged breach was known or was constructively known by Purchaser at the time Purchaser entered into this Agreement.*
- (d) *The warranties and any liabilities of Vendor is subject to the matters contained or referred to in the Disclosure Materials and the warranties do not apply to those matters. Any breach of warranty will not be enforceable against Vendor to the extent that it is shown that the inaccuracy, error or omission underlying the alleged breach was identifiable from the Disclosure Materials*

- (e) *Purchaser acknowledges that it has had the opportunity to examine the Disclosure Materials, seek independent advice in relation to the Company, to conduct a due diligence exercise in relation to the Company and to obtain information in respect of those matters that Purchaser considers relevant, and that a Purchaser would reasonably consider relevant, to entering into this Agreement and that it has knowledge and experience in [ relevant industry], and other business matters and is therefore capable of evaluating the merits and risks associated with entering into this Agreement.*

## 1.2 Knowledge

*Where any Warranty is qualified by any reference to the knowledge or awareness or belief of Vendor, this shall mean the knowledge or awareness of the directors of Vendor, and there shall be implied in that warranty or representation a warranty that such individuals have made reasonable enquiries within relevant Vendor's senior management concerning the subject matter of that knowledge, awareness or belief.*

## 2 Limitation on Claims

### 2.1 Limitations

*Except as otherwise specifically provided in this Agreement, the Purchaser's right to make a claim for any breach, action, damage, loss, expense, tax, liability, or obligation whatsoever made, suffered or arising under or in relation to this Agreement (each a "claim") (whether relating to a breach of Warranties under clause [ ] of this Agreement or a claim under the indemnities in clause [ ] of this Agreement or otherwise) is limited as follows:*

- (a) *Purchaser must give written notice to Vendor of the specific claim in question within the Warranty Claim Period;*
- (b) *Purchaser may only bring a claim for an event or circumstances or series of events or circumstances if the amount reasonably claimed exceeds \$50,000;*
- (c) *the maximum aggregate amount that the Purchaser may recover in total from the Vendor in relation to one or more claims under this Agreement is \$500,000;*
- (d) *where a claim relates to a breach of Vendor's warranties, the quantum of any liability Vendor has to Purchaser under or in relation to this Agreement will be determined solely by reference to the effect on the value of the Shares which results from the facts, matters or circumstances on which the claim is based not being as warranted;*
- (e) *each of Vendor's warranties is given subject to*
- (i) *anything done, or omitted to be done, either under any provision of this Agreement or after the date of this Agreement at the request of, or with the approval of, Purchaser;*
- (ii) *any matter to the extent that it was taken into account in calculating the amount of any allowance, provision or reserve, or was noted in, any financial statements included in the Disclosure Materials;*
- (f) *Purchaser has no right to cancel this Agreement (whether before or after Settlement) as a result of any matter giving rise to a claim under a Warranty;*
- (g) *a breach of Warranty shall not give rise to any other or separate cause of action for damages or other relief from misrepresentation or breach of representation or warranty or otherwise;*
- (h) *no claim may be made by the Purchaser while it is in breach of its obligations under this Agreement;*

- (i) *no claim may be made which relates to any event, circumstances or matter preceding the date on which Vendor acquired the specific asset to which the breach relates, except to the extent that Vendor has a right to bring a claim for such event, circumstance or matter;*
- (j) *no claim may be made to the extent that the relevant event would not have arisen but for:*
  - (i) *a breach of the law or contract, or commission of a tort by Purchaser;*
  - (ii) *any obligation or commitment entered into by Purchaser after Settlement (Other than an obligation or commitment based on a breach of Warranty by Vendor);*
  - (iii) *Purchaser admitting liability without the prior written consent of Vendor; or*
  - (iv) *a change in the law occurring after the date of this Agreement, except to the extent that Vendor has a right to bring a claim as a result of such claim;*
- (k) *Purchaser shall not recover more than once in respect of any one matter giving rise to a claim;*
- (l) *in assessing any damages recoverable for any claim there is to be deducted any savings by, or net benefit to, Purchaser arising directly from the relevant event, circumstances, loss, liability, cost or expense to which the payment relates;*
- (m) *if Vendor makes any payment as a result of a claim ("Vendor's Payment") and Purchaser receives any benefit otherwise than from Vendor which would not have been received but for the circumstances giving rise to the claim in relation to which Vendor's Payment was made Purchaser will, once such benefit has been received, immediately pay to Vendor an amount equal to the lesser of Vendor's Payment and the amount of such benefit.*

## 2.2 Notice of circumstances

*Purchaser shall give notice to Vendor as soon as reasonably practicable after it becomes aware of circumstances that could reasonably be expected to form the basis of a claim under this Agreement, regardless of value.*