

THE VITAL ROLE OF LIMITATION OF LIABILITY IN BUSINESS CONTRACTS / STANDARD TERMS AND CONDITIONS

A limitation of liability clause is an essential tool in contract negotiations, determining the extent to which one party must compensate the other in the event of a breach of the contract.

Understanding Limitation of Liability Clauses

A limitation of liability clause places constraints on the potential compensation one party can seek from the other party due to contract-related losses. **It effectively places a cap on one party's liability and mitigates the risk of claims by the other party.**

Why You Need a Limitation of Liability Clause

Limitation of liability clauses serve as risk management tools in contracts. Without such a clause, there are no financial limits on the damages one party can claim. Parties seeking to reduce their exposure to contract-related risks should incorporate an explicit limitation of liability clause into their agreements.

Statutory Limits

At the outset, it is worth noting that when the contract is between two businesses, limitation of liability is prohibited under the Unfair Contract Terms Act 1977 in the following circumstances:

- death and personal injury caused by negligence
- misrepresentation
- breach of terms implied by the law that are not expressly mentioned in the contract (eg the quality and fitness for purpose of goods should be guaranteed even if there is no express term in the agreement)

Drafting the Limitation of Liability Clause for your Business

When drafting the limitation clause, it is important to identify the contract's associated risks and potential losses. For example,

- What are the potential pitfalls in the transaction?
- How likely is a breach of contract?
- What could be the financial implications, and can you afford them?
- Are there economic risks inherent to this contract or industry?

With risk assessment in mind, your limitation clause should be drafted using clear and unambiguous language. It should specify:

- The types of losses each party accepts to compensate without limit (e.g., fraud, death, and personal injury).
- The types of losses subject to caps, with precise amounts for each type (caps may vary depending on factors like insurance coverage, contract value, or potential damages from a breach).
- The types of losses entirely excluded from liability (such as indirect or consequential losses)

In conclusion, limitation of liability clauses are indispensable safeguards - by having a well drafted limitation of liability clause in your unique contract or standard terms and conditions, you can effectively manage risks and protect your business interests.

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