ISSUES IN THE DRAFTING AND USE OF EXCLUSION CLAUSES IN COMMERCIAL AGREEMENTS

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INTRODUCTION

Exclusion, exemption and limitation clauses are labels applied to those clauses in contracts which attempt to exclude or limit liability either by way of degree or scope. Generally these types of clauses are known as ‘exclusion clauses’.

Exclusion clauses are common in contracts for the engagement of consulting professionals such as engineers and architects. This article examines the operation and effectiveness of such clauses in the following standard form contracts in order to highlight issues that should be considered in the drafting and use of exclusion clauses in general:


2. The ACEA Contract Between Client and Consulting Engineer for Professional Services, published by the Association of Consulting Engineers Australia.

It is appropriate to first briefly consider the law governing the interpretation of these clauses.

THE LAW APPLICING TO EXCLUSION CLAUSES

General

The High Court of Australia and the House of Lords of England have stated that apart from those imposed by legislation, there are no special rules of law applying to the interpretation of exclusion clauses in contracts but, rather, it is purely a matter of construction. 1 Doctrines such as ‘fundamental breach’ propounded by Lord Denning in a series of cases, 2 are, to some extent, illusory. That is not to say that all of the cases that applied doctrines such as fundamental breach, total breach, and the main purpose rule are irrelevant to the examination of exclusion clauses. Provided that the principles espoused under the umbrella of those doctrines are not applied as rules of law but rather as rules of construction, they give a relevant guide to interpretation.

The correct approach to the interpretation of exclusion clauses is summarised by the High Court in Darlington Futures Limited v Delco Australia Pty Ltd:3

...the interpretation of an exclusion clause is to be determined by construing the clause according to its natural and ordinary meaning, read in light of the contract as a whole, thereby giving due weight to the context in which the clause appears including the nature and object of the contract, and, where appropriate, construing the clause contra proferentem in case of ambiguity.

Although the rules of construction with respect to exclusion clauses may result in courts consistently reading down the operation of those clauses, it should be noted that an exclusion clause is contrary to the intent of the contract, that is, that goods or services should be provided by one party to another in a reasonable and competent manner. Therefore, exclusion clauses must be drafted in very clear language that identifies the liability that is excluded and use terms that are consistent with the contract, and legislation governing the contract. 4

Exclusion of Liability for Negligence and Wilful Breaches

If an exclusion clause is to deny liability for negligence very clear words are required. 5 The reason for this is that the courts consider that it is unlikely that it was the intention of a party, when
entering into a contract, to forego fundamental rights such as a person providing services with due care, skill and diligence.6

A professional’s liability will lie in both contract and tort.7 It is unlikely, even in the area of negligence, that it will be necessary for the recipient of professional services to need to show reliance on the advice of the professional, as the recipient is entitled to assume that all work was completed in a reasonable and competent manner.8

Although it has been stated in some cases that exclusion clauses do not apply to 'wilful' breaches of duty, and there may indeed be public policy grounds for such an interpretation of exclusion clauses, it is clear from the statements made by the House of Lords in Suisse Atlantique9 that this is not the case. In that case the House of Lords stated that the question of whether wilful breach was covered by an exclusion clause is a matter of construction.

It should, however, be remembered that an exclusion clause cannot operate so widely as to remove the existence of consideration passing between the professional and his client, as this would remove from the agreement the legal characteristics of a contract.10

Liability Under the Trade Practices Act
When considering exclusion clauses, parties must be particularly mindful of provisions of the Trade Practices Act 1974 (Cth). In addition, non–corporate consultants, depending on their circumstances, may not be covered by the Trade Practices Act and should also consider similar provisions in relevant state and territory Fair Trading legislation.

Liability for misleading and deceptive conduct under section 52 of the Trade Practices Act11 cannot be excluded, although a declaration regarding the extent of information relied upon in entering the contract can provide a useful evidentiary basis for limiting its impact.

Similarly incapable of exclusion is section 74,12 which, where the value of services provided by the consultant is $40,000 or less, can imply into the contract a warranty that those services must be provided with due care and skill. Section 74 can also in such circumstances require that the services be reasonably fit for their purpose, however, this warranty does not apply to professional services provided by a qualified architect or engineer.13 To reduce the impact of section 74, the parties may avail themselves of section 68A to limit liability, where it is reasonable to do so, to the resupply of those services or the costs of resupplying of those services.

INTERPRETATION OF THE EXCLUSION CLAUSES IN STANDARD FORM CONTRACTS
AS4122 (Interim)–1993
and AS4122–2000 General Conditions for Engagement of Consultants
Exclusion of liability is found in the AS4122 (Interim)–1993 contract in clause 10.1(c), which reads:

The Consultant shall—
(c) be liable only for loss or damage suffered by the Principal as a result of any negligent act, error, omission or statement by the Consultants or the Consultants’ employees, agents or subconsultants to the limits (if any) set out in the Annexure.

Exclusion, exemption and limitation clauses are labels applied to those clauses in contracts which attempt to exclude or limit liability either by way of degree or scope. Generally these types of clauses are known as ‘exclusion clauses’.
While not perfectly clear, it appears that under this clause the consultant is only liable where the consultant, vicariously or otherwise, has been negligent in the performance of its duties. The contract then allows the parties to set monetary limits, as well as limits to the scope of negligent conduct for which liability is accepted.

The liability provision in the finalised 2000 edition of the AS 4122 contract is, however, somewhat less generous to consultants. Clause 9.1 of that contract provides:

Where a monetary limit of liability is stated in Item 14, the Consultant’s liability to the Client arising out of the performance or non–performance of the services, whether under the law of contract, tort or otherwise, shall be limited to that monetary limit of liability.

Most notably, the 2000 version fails to exclude the consultant’s liability for things falling short of negligence. In fact, it does not exclude any particular type of liability at all, it merely allows the parties to set a monetary cap in the Annexure. 

This cap, however, only applies to liability arising out of the performance or non–performance of the services. Given the contract’s definition of services, even if a liability cap is specified it is unlikely to address loss arising purely out of work additional to that ‘described in the brief’ or ‘required to [be carried] out under the contract’.

In addition, it is not clear whether the 2000 contract’s cap will apply to liability for negligence. Negligence should ideally be referred to by name (or a clear synonym) in clauses intended to exclude or limit that basis for liability. While some alternative constructions have been held to effectively exclude negligence in some circumstances, there is no certainty that ‘contract, tort or otherwise’ will be adequate in this contract, let alone the varying scenarios in which it may be used.\(^\text{17}\)

Clause 2 of the 2000 contract does, however, address the duty of care to be satisfied by the consultant:

The Consultant shall perform the Services to that standard of care and skill to be expected of a Consultant who regularly acts in the capacity in which the Consultant is engaged and who possesses the knowledge, skill and experience of a Consultant qualified to act in that capacity.

Like the clause 9.1 cap, this provision only applies to ‘the services’, leading to a potentially different standard for anything else the consultant provides, one that may be inappropriately high, for example, where the consultant is asked to give additional advice regarding matters beyond the scope of its specific engagement. Such a provision is notably lacking from the 1993 contract—a concern given the tendency towards highly specialised consultancies.

Both AS contracts rely too heavily on the ability of the parties to define their own scope of liability and monetary caps. In particular, the 2000 clause does not allow the parties to limit the scope of a consultant’s liability without amending the contract’s terms. Considering that it is a standard form contract and to be used by all levels of industry, it should consider the needs of inexperienced parties who are not in a position to define their own limits for the liability of the consultant. A more rigorous clause that clearly defines suggested parameters for the operation of the exclusion clause would be far more effective in focusing the minds of inexperienced parties on the issues arising out of the possible liability of the professional consultant.

The 1993 contract’s clause 10.1(c) also fails to deal with the possibility that the contract may be one within the scope of operation of all provisions of the Trade Practices Act, potentially exposing the consultant to the implied warranties of section 74.\(^\text{18}\) By section 68 it is not possible to contract out of this provision, and an attempt to do so risks exposing the parties to sanctions as well as being ineffective. Consequently, the exclusion clause should state that it does not apply so far as the Trade Practices Act may effect the supply of goods and services by the consultant to the principal.

Fortunately, the 2000 contract addresses this issue at the second paragraph of clause 9.1. So far as the contracts may apply to the provision of consulting services which have a value of $40,000 or less, the exclusion clause should employ the allowed limitation of liability detailed in section 68A of the Trade Practices Act.

Finally, neither of the AS contracts attempt to deal with the liability imposed upon the parties by virtue of section 52 of the Trade Practices Act. Although it is difficult to effect the liability flowing from a breach of section 52, the scope of operation can be reduced if the parties include a provision which deals with the level of reliance that has been made by the parties on the information passing between them at the pre–contract stage.
ACEA Contract Between Client and Consulting Engineer for Professional Services
Notably, clause 4 of the ACEA Contract deals with a substantial number of the issues that arise in relation to the exclusion of liability and would, therefore, serve to focus the minds of inexperienced parties on those issues.

Clauses 4.1 and 4.2 exclude liability for certain types of losses but only ‘to the maximum extent permitted by law’, to avoid falling foul of the Trade Practices Act’s anti-exclusory section 68. The exclusion applies to ‘any common exclusion from insurance cover including asbestos, toxic mould and terrorism’ as well as ‘any indirect, special and consequential losses’ and includes a further list of types of losses such as ‘loss of profit’. Noticeably lacking, however, is an exclusion for ‘pure economic loss’ to catch losses arising from the client’s particular circumstances but flowing directly from the consultant’s breach of contract or negligence and not contemplated by the list.

For those things not addressed by the exclusion clauses, clause 4.1 of the ACEA Contract also provides for the parties to agree to a liability cap, also ‘to the maximum extent permitted by law’. However, as no default cap is provided, it will not operate if the parties fail to name a cap in the Schedule.

Clause 4.3 allows the parties to limit the duration of the consultant’s liability (also to the extent legally permissible). A default period of ‘three years from completion of the services’ is provided in the event that the parties do not modify the Schedule. This provision is particularly useful for addressing liability for latent defects, the duration of which can extend for up to six years from when they ought to have been discovered. As some latent defects may not be discoverable for many years, the duration of such liability, if not limited, can be theoretically perpetual. Note, however, that clause 4.3 only applies to ‘liability in respect of the services’—the monetary cap and exclusion provisions are not so restricted and would likely apply to those things the consultant provides in addition to the ‘services’.

A provision as to the standard of care to be exercised by the consultant is present in the ACEA Contract at clause 1.1 and its operation is also restricted to provision of the ‘services’, risking a higher standard of care than that generally exercised by competent members of the engineering profession performing services of a similar nature for any work performed beyond the ‘services’.

The ACEA Contract is also notably inconsistent in dealing with negligence. The exclusion in clause 4.2 provides an adequate formulation against such liability, applying to losses ‘howsoever arising, whether under contract, in tort, in equity, under statute or otherwise’. While negligence is not, as would be ideal, expressly named, by identifying all other bases of liability, the word ‘otherwise’ most likely refers to negligence. Use of ‘howsoever arising’ also supports this construction. However, these words are omitted from an otherwise identical framing of the relevant bases of liability for the clause 4.1 cap and clause 4.3 limitation of the duration of liability.

Clause 4.4, ‘Extent of Warranty’, provides both an exclusion of implied warranties and a fuller treatment of the implications of sections 68 and 68A of the Trade Practices Act and equivalent provisions of state Fair Trading legislation. The subsection (4) mechanism used to apply the allowable limitation of section 68A could, however, be improved as the drafting relies on the other liability provisions being void for the limitation to operate. Rather, those other provisions should be subject to clause 4.4(4) and that limitation should operate ‘to the extent that [the other clauses] would be void but for the operation of this clause 4.4(4)’.

General Problems with the Standard Form Provisions for the Exclusion of Liability
The AS and ACEA contracts fail to deal with the possibility of a professional consultant becoming liable to the principal, despite the exclusion of liability provisions, by virtue of the negligence of the professional consultant’s employees, agents or subconsultants, to which the professional consultant has contributed or is proportionately liable (pursuant to recent tort reform legislation) or for which the employees, agents or subconsultants are entitled to an indemnity. This is a significant potential source of liability for the consultant and should be addressed by the exclusion clauses also applying for the benefit of such employees, agents and subconsultants.

The exclusion clauses we have examined also fail to address the consultant’s liability to subsequent owners of the relevant property. As a result of the High Court’s decision in Bryan v Maloney, consultants can, in some circumstances, be liable to subsequent purchasers of property, despite liability for the breach of the relevant duty being excluded in the contract between the consultant and the original owner/principal. This is a matter than exclusion clauses should seek to address.
To have a truly effective exclusion of liability clause it is necessary for the parties to a contract to turn their minds to the allocation of risks under the contract and the associated acceptance or denial of liability.

**IMPROVING EXCLUSION CLAUSES**

A strong exclusion of liability clause for a consultant should:

- exclude all implied conditions and warranties to the extent permitted by law;
- specifically address liability for negligence if the parties intend to limit or exclude such liability, and are satisfied that doing so will not remove the consideration flowing from the consultant for the agreement;
- exclude liability for types of loss that can potentially run to large amounts depending on the client’s individual circumstances, in particular ‘special’, ‘indirect’, ‘consequential’ and ‘pure economic’ losses;
- exclude liability for types of work performed by the consultant beyond their field of expertise or over and above that required by the contract;
- for forms of liability that are not or cannot be excluded, to the extent possible:
  - limit liability to resupplying the services or the cost of resupplying the services, at the consultant’s option; or
  - where the principal requires that the consultant accept greater liability, or the restrictions of section 68 of the Trade Practices Act do not apply and a lesser liability cap is sought, provide alternative monetary, and where appropriate, time limits to liability. Such limits should not be greater than provided for under relevant insurance polices;
- aim to reduce the potential impact of section 52 of the Trade Practices Act by including a clear declaration that the parties entered into the contract solely on the basis of the information contained in the brief;
- apply the above exclusions and limitations not only for the benefit of the consultant but also its employees, agents and subconsultants to avoid the possibility of the consultant becoming liable to the principal by virtue of an indemnity, right of contribution or proportionate liability (pursuant to recent tort reform legislation) existing between the consultant and the consultant’s employees, agents and subconsultants; and
- provide an indemnity for the benefit of the consultant insofar as the consultant may become liable to third parties where it would not become liable to the principal so as to the extent possible overcome the difficulties posed by the High Court’s decision in Bryan v Maloney.

**CONCLUSION**

To have a truly effective exclusion of liability clause it is necessary for the parties to a contract to turn their minds to the allocation of risks under the contract and the associated acceptance or denial of liability.

Insofar as an exclusion clause is provided by standard form contracts, it is important that those clauses are structured so that they focus the minds of the parties on all aspects of the exclusion of liability. Further, should the parties fail to focus their minds on the question of exclusion of liability, the clause must be drafted in such a manner that it continues to operate reasonably.

**REFERENCES**

1. Council of the City of Sydney v West (1965) 114 CLR 481; Suisse Atlantique Societe d’Arment Maritime SA v Rottendamsche Kolen Centrale [1967] 1 AC 361
2. See J Spelling v Bradshaw (1956) 2 All ER 121; Karsales (Harrow) Ltd v Wallace (1956) 2 All ER 866; Chapterhouse Credit Company v Polley (1963) 2B 683;
14. It is a shortcoming of both AS4122 contracts that neither provide standard arbitrary limits to liability but instead rely on the parties appropriately amending the Annexure.

15. Note, however, that as the words ‘arising out of’ do not require a direct or proximate relationship between the relevant activity and loss (see Dickenson v Motor Vehicle Insurance Trust (1987) 163 CLR 500 at 505 per Mason CJ, Wilson, Brennan, Dawson and Toohey JJ), there is some scope for an event of liability to arise from both a ‘service’ (within its meaning in the AS4122–2000) and another act of the consultant. Consequently, such liability may be covered by the cap.

16. The same principles apply to the construction of limitation clauses: Darlington Futures Limited v Delco Australia Pty Ltd (1986) 161 CLR 500, at 510

17. Consider, for example, the similar facts and wording of the exclusion clauses in Davis v Pearce Parking Station Pty Ltd (1954) 91 CLR 642 and Council of the City of Sydney v West (1965) 114 CLR 481 yet the High Court’s markedly different findings as to each clause’s effect.

18. Note that, as discussed above, s 74 will not apply where the value of the services provided exceeds $40,000. The fitness for purpose warranty in s 74(2) will also not apply to professional services provided by a qualified architect or engineer. In addition, non–corporate consultants, depending on their circumstances, may not be covered by the Trade Practices Act and should also consider equivalent provisions in relevant state Fair Trading legislation, for example, s 40S of the Fair Trading Act 1987 (NSW)

19. See Tapsell, K, ‘Bryan v Maloney: Model or Liability to An Indeterminate Number of the Same Class’ (1996) 12 BCL 154

20. (1994) 182 CLR 609

21. Note, for example, the different outcome of Woolcock Street Investments Pty Ltd v CDG Pty Ltd (2004) 216 CLR 515, in which a duty of care to the original owner was not established. The appellant in Woolcock also failed to demonstrate sufficient vulnerability to establish a good claim for damages for pure economic loss.

22. Or where relevant, similar restrictions in state Fair Trading legislation.