

EXCLUDING OR LIMITING LIABILITY IN COMMERCIAL CONTRACTS

A paper presented by Michael Bennett for the Television Education Network

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Contents

1	Overview	4
2	Limitation of Liability	5
2.1	Classification of Exclusion Clauses	6
2.2	Relationship with Entire Agreement	6
2.3	Use of Warranties and Indemnities	6
3	Interpretation of Exclusion Clauses	9
3.1	Strictness of Limitation	10
3.2	<i>Contra Proferentem Rule</i>	10
3.3	Circumscription of Cover Principle	11
3.4	Insurance Contracts Specifically	12
3.5	Nature of the Breach	13
4	Excluding or Limiting Certain Heads of Damage	15
4.1	What to Note When Drafting	15
4.2	Direct Loss v Indirect Loss	16
4.3	Caps v Carve Outs	18
4.4	Time to Percolate	18
5	Agreed Damages Clauses	20
6	Statutory Incursions	22
6.1	Generally	22
6.2	ACL: Generally	22
6.3	ACL: Misleading and Deceptive Conduct	22
6.4	Insurance	24
6.5	Unfair Contracts	24
7	Case Law Update	25
7.1	Chubb	25

1 Overview

Exclusion clauses are those that “cut out something already included by the general recitals and provisions”: Viscount Sumner in *Lake v Simmons* [1927] AC 487 at 507. While there are recognised categories of exclusion (or exemption) clauses such as ‘sold with all faults’ or ‘own at risk’ (as is noted in *Cheshire and Fifoot Law of Contract*, 11th Australian Edition, page 524) the definition and concept of an exemption clause is an open one.

Exclusion clauses present a significant tool for the typical commercial client, and a minefield for the lawyer drafting them; a relatively recent case in the Full Court of the Federal Court of Australia reviewed an exclusion clause drafted in the usual terms for exclusion of professional services liability (*Chubb Insurance Company of Australia Limited v Robinson* [2016] FCAFC 17).

To ensure that the clause itself has the intended effect, care should be taken to ensure that the drafting is that to which a court will give effect, in light of general principles of contract interpretation, statutory prohibitions, and the application of the *contra preferentum* rule. In the case of insurance contracts, particular care needs to be taken not to offend the circumscription of cover rule.

Of course, if an exemption clause is too wide in its reach, it risks negating the contract as a whole, leaving no room for the formation of a contract in the first place: see *MacRobertson Miller Airline Services v Commissioner of State Taxation (WA)* (1975) 133 CLR 125.

This paper will:

- explore salient principals that are relevant to exclusions clause litigation, with a focus on the approach in *Chubb Insurance Company of Australia Limited v Robinson* [2016] FCAFC 17;
- How they with the rest of the agreement
- Use of warranties and indemnities;
- consider how to interpret exclusion clauses;
- consider the way to limit heads of damages (including direct v indirect loss, caps v carve outs and taking time to draft);
- agreed damages / liquidated damages clauses; and
- dealing with legislative incursions to exclusion clauses.

It will be seen that exclusion clauses are a useful tool but, given the court’s approach to them, one that needs to be properly and carefully deployed to ensure the intended effect is obtained.

2 Limitation of Liability

Carter and Harland (*Contract Law in Australia*, Fourth Edition, p 263) conveniently identify three types of exclusion clause, namely, those that:

- (1) exclude the rights that a party otherwise enjoys by the terms of the contract or at law;
- (2) restrict the rights of one party without necessarily excluding the liability of the other party;
- (3) qualify rights by subjecting them to specified procedures.

Although exclusion clauses take various forms, they function either to define obligations, duties, rights or liabilities, or to provide a promisor with a defence to an action for breach of duty.

Common examples of exclusion, limitation or exemption clauses are:

- financial cap on overall liability and/or caps on different liabilities;
- setting fixed or “liquidated damages” or “service credits” payments;
- exclusion of specific heads of loss, such as loss of profits, revenue, anticipated savings, data, et cetera;
- exclusion of consequential or indirect losses;
- time bars on claims, both within and after the term of the agreement;
- exclusion of certain warranties, conditions or other terms implied by statute or otherwise, e.g. satisfactory quality and fitness for purpose, et cetera;
- excluding liability due to force majeure, i.e. matters beyond the party’s reasonable control;
- exclusion of specific remedies, e.g. specific performance, set-off rights;
- conditions to specific remedies, e.g. paying the return costs of defective goods;
- reverse indemnities, e.g. customer indemnifying supplier for liability beyond that expressly accepted by supplier;

- entire agreement clauses and non-reliance upon prior representations.

They remain, however, contractual terms. They are therefore subject to the usual process of classification and construction.

2.1 Classification of Exclusion Clauses

Exclusion clauses are not themselves subject to the tripartite classification. Because of conventional treatment of exclusion clauses as providing defences, rather than as defining obligations, such provisions have not often been analysed by reference to their impact on the classification of a promissory term.

The courts have often construed the exclusion clause by reference to the gravity or seriousness of the rights it seeks to limit or exclude.

2.2 Relationship with Entire Agreement

Generally, and reflecting the assumption that a contracting party is subject to an absolute duty to perform, exclusion clauses have been treated as having a defensive function: *Owners of SS Istros v F W Dahlstroem & Co* [1931] 1 KB 247 at 252-253; *Karsales (Harrow) Ltd v Wallis* [1956] 1 WLR 936 at 940. For that reason, the promisor has often been treated as subject to the burden of proof, to show that the exclusion clause is a defence which is applicable to a breach of duty (failure to perform) established without reference to the exclusion.

However, where an exclusion clause defines the scope of an obligation, or its standard of duty, it must be taken into account when deciding whether a failure to perform has occurred: *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827 at 851 per Lord Diplock. There is therefore a contrast between an exclusion clause which is an effective defence and an exclusion clause which has so defined the promisor's obligations that there is no failure to perform.

Although it might be thought that the conception of a binding agreement is incompatible with the presence of a clause which excludes all liability for breach, no matter how serious, there is no rule of law to that effect: cf *Firestone Tyre and Rubber Co Ltd v Vokins & Co* [1951] 1 Lloyd's Rep 32 at 39. It is a question of construction, though a court will start from the position that it is unlikely to have been the parties' intention to achieve such an outcome: *Suisse Atlantique Societe d'Armement Maritime SA v NV Rotterdamsche Kolen Centrale* [1967] 1 AC 361 at 433 per Lord Wilberforce.

2.3 Use of Warranties and Indemnities

Commercial contracts also often include an indemnity clause. Traditionally this is a promise to 'hold harmless' the other party or parties, should a specified outcome arise. The event or outcome typically includes a breach of the relevant agreement or obligations of performance under it. It could, however, also include other events such as events over which the indemnifying party has not control.

When considering an indemnity you are dealing with risk allocation. The giver of the indemnity is assuming risk from the recipient of the indemnity.

However, they too remain contractual terms to be classified and construed. Applying the principles of construction outlined above, broadly drafted indemnities may ultimately be construed by the courts much more narrowly than the parties had intended to be the case.

The High Court's decision in *Andar Transport Pty Limited v Brambles Limited* (2004) 317 CLR 424 is a good example of this. There, a contract between the parties – Brambles being the provider of laundry delivery services to hospitals and Andar Transports an independent contractor assisting to that end – included a broad indemnity by Andar to Brambles. A director and shareholder of Andar was injured during a delivery round. He tried to separate two laundry trolleys that were joined and injured himself in the process; he sued Brambles based on the trolleys' lack of manoeuvrability. He won.

In the ultimate appeal to the High Court the majority held that indemnity provisions (as opposed to other types of clauses that purport to limit or exclude liability) in commercial contracts ought to be treated in the same way as guarantees in suretyship contracts because (at 437):

... notwithstanding the differences in the operation of guarantees and indemnities, both are designed to satisfy a liability owed by someone other than the guarantor or the indemnifier to the third person.

The majority quoted from *Ankar Pty Ltd v National Westminster Finance (Australia) Limited* (1987) 162 CLR 549 at 433, that:

At law, as in equity, the traditional view is that the liability of the surety is strictissimi juris and that ambiguous contractual provisions should be construed in favour of the surety.

As the indemnity clause did not strictly mention Brambles own negligence, and based on the *contra preferentem* rule apply against Brambles, the clause was held not to cover – and therefore not indemnify – Brambles own negligence.

The position has been touched upon, and summarised, since then: *Gardiner v Agricultural and Rural Finance Pty Ltd Limited* [2007] NSWCA 235 at [11]-[13] per Spigelman CJ¹ and *Waterways Authority of New South Wales v Coal & Allied (Operations) Pty Limited* [2007] NSWCA 276 at [238] per McColl JA.

Some doubt was then case by *Kooee Communications Pty Limited v Primus Telecommunications Pty Limited* [2008] NSWCA 5 at [30]-[38] by Basten JA (Giles & Tobias JJA concurring), warning of adverse consequences of re-writing commercial contracts under the guise of interpreting them.

¹ Although overturned in the High Court, this aspect of the decision was not revisited.

3 Interpretation of Exclusion Clauses

As discussed in *Chubb* at [83], citing Kenny J at first instance, in a decision in which an exclusion clause was relied upon in an attempt to avoid liability under an insuring clause, as a starting point:

...the overarching principle relevant to the interpretation of commercial contracts, including insurance contracts, is that such contracts should be given a businesslike interpretation. Interpreting a commercial document requires attention to be given to the language used by the parties, the commercial circumstances which the document addresses and the objects which it is intended to secure (per Gleeson CJ in *McCann v Switzerland Insurance Australia Ltd* [2000] HCA 65; (2000) 203 CLR 579 (McCann) at 589 [22]).

Turning to exclusion clauses in particular, the Full Court in *Chubb* at [83], again quoting her Honour Kenny J at first instance, pointed to the High Court's decision in *Darlington Futures Limited v Delco Australia Pty Ltd* [1986] HCA 82; (1986) 161 CLR 500 at 510-511 where the Court said:²

[T]he interpretation of an exclusion clause is to be determined by construing the clause according to its natural and ordinary meaning, read in the 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. ... [T]he principle, in the form in which we have expressed it, does no more than express the general approach to the interpretation of contracts and it is of sufficient generality to accommodate the different considerations that may arise in the interpretation of a wide variety of exclusion and limitation clauses in formal commercial contracts between business people where no question of the reasonableness or fairness of the clause arises.

For a succinct summary of the rules on interpreting exclusion clauses, albeit in an insurance policy context, see *Malamit Pty Ltd v WFI Insurance Ltd & Ors* [2016] NSWSC 1306 at [32]-[34], where Sackar J said:

32. In *Darlington Futures Limited v Delco Australia Pty Ltd* [1986] HCA 82; (1986) 161 CLR 500 at 510-511, Mason, Wilson, Brennan, Deane and Dawson JJ explained:

[His Honour then set out the quote above].

² See also *Sydney Corporation v West* (1965) 114 CLR 481; *Thomas National Transport (Melbourne) Pty Ltd v May & Baker (Australia) Pty Ltd* (1966) 115 CLR 353; *Suisse Atlantique Societe d'Armement Maritime SA b NV Rotterdamsche Kolen Centrale* [1967] 1 AC 361; *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827; *Port Jackson Stevedoring Pty Ltd Salmond & Spraggon (Australia) Pty Ltd* (1980) 144 CLR 300; [1981] 1 WLR 138; *Ailsa Craig Fishing Co Ltd v Malvern Fishing Co Ltd* [1983] q W:R 964.

33. Similarly, in *Selected Seeds Pty Ltd v QBEMM Pty Ltd* [2010] HCA 37; (2010) 242 CLR 336 at 344 [29], French CJ, Hayne, Crennan, Kiefel and Bell JJ stated:

According to general rules of construction, whilst regard must be had to the language used in an exclusion clause, such a clause must be read in light of the contract of insurance as a whole, thereby giving due weight to the context in which the clause appears. (see also *Darlington Futures Ltd v Delco Australia Pty Ltd* [1986] HCA 82; (1986) 161 CLR 500 at 510)

34. A court will endeavour to construe an exclusion clause in a manner consistent with the commercial purpose of the contract of insurance, and where possible, avoid the exclusion operating so as to substantially defeat the indemnity granted by the policy and render the policy ‘practically illusory’: *Alex Kay Pty Ltd v General Motors Acceptance Corporation* [1963] VicRp 66; [1963] VR 458 at 462-463; *Fraser v BN Furman (Productions) Limited* [1967] 1 WLR 898 at 905-906; *Liberty International Underwriters v The Salisbury Group Pty Ltd (in liq) & Ors* [2014] QSC 240 at [31].

Important aspects are further discussed below.

3.1 Strictness of Limitation

While ordinary principles of contract might apply, the High Court has shown a willingness to be particularly strict with the meaning it will attribute to the words used in an exclusions clause. For instance, in *Insight Vacations Pty Ltd v Young* (2011) 243 CLR 149, the plaintiff sued a tour company for an injury sustained while standing on a tour bus that broke suddenly. The Court reviewed an exclusion clause which was to apply, “[w]here the passenger occupies a motorcoach seat fitted with a safety belt”. The Court held that the exemption did not apply to the present circumstances where the passenger was not at the time of the relevant conduct, occupying a seat on the bus, but was instead standing to reach overhead luggage: *Insight* at [38], [39].

3.2 Contra Preferentem Rule

The contra preferentem rule allows a contract clause to be construed against the party that is seeking to rely upon it. However it is only available where an ambiguity remains after application of the accepted principles of contract interpretation: *Metricon Homes Pty Ltd v Great Lakes Insurance SE* [2017] VSC 749 at [37].

That the contra preferentem rule is available only in the case of ambiguity is highlighted by Kenny J at first instance in *Chubb (470 St Kilda Road v Robinson* [2013] FCA 1420) at [68]:

According to many authorities, the rule is one “of last resort”, in the sense that there remains ambiguity after the application of the other relevant principles of construction... If an exclusion clause in an insurance policy is open to two interpretations, one of which would inappropriately circumscribe the cover provided by the insuring clause, and one which would not, the latter is to be preferred (citing *Fitzpatrick v Job* [2007] WASCA 63; (2007) 14 ANZ Insurance Cases 61-731 (*Fitzpatrick v Job*))... The onus of proof in relation to the applicability of an exclusion clause in any given circumstances rests upon the insurer.

The Full Court in *Chubb* endorsed the approach to the *contra preferentem* rule taken by the trial judge (Full Court at [167]).

Exclusions clauses are therefore an area where the *contra preferentem* rule seems to resist its otherwise ongoing restriction of use.

3.3 Circumscription of Cover Principle

Exclusion clauses must be construed so as to not inappropriately circumscribe the object of the contract (often, in the case of an insurance contract, the insuring clause). As noted in *Cate Doosey v Nigel Walsh & Complete Building Inspection Services Pty. Ltd.* [2017] NSWDC 8 at [275], their purpose is to affect the contractual prescription of the promised field of cover by providing the boundaries to the scope of cover.

The Full Court in *Chubb* also endorsed the approach to the circumscription of cover principle taken by the trial judge (Full Court at [167]).

It was acknowledged in *Fitzpatrick v Job* [2007] WASCA 63; (2007) 14 ANZ Insurance Cases 61-731 at 76,076 [264] that in an insurance contract, the meaning of a term – in that case, the word “professional” – as it sat in the insuring clause would not have the same meaning as set out in the exclusion clause; much was acknowledged in *Chubb* at first instance and on appeal (as to the latter see [143]).

In *Fitzpatrick*, the insured was operating in the business of “the design, manufacture and supply of machinery and equipment, including the machine in question with and without a cabin”: *Fitzpatrick* at 76,076 [267] and 76,076–76,077 [268]. The GIO provided by the terms of an indemnity clause, indemnity in respect of sums that the insured “shall become legally liable to pay for compensation in respect of bodily injury or damage to property as a result of an occurrence” and caused by “the nature, condition or quality” of any goods or products sold or supplied by it”. There was an exclusion clause which provided a carve out on the part of GIO from any liability arising out of a breach of a duty owed in a professional capacity. The court held in that case that at 76,076 [267] to 76,077 [270]:³

³ Although lengthy, this passage bears repeating in full.

If any and all negligent acts and omissions of Jobs Engineering, of the kind I have just mentioned, were to be characterised as breaches of duty owed by it in a professional capacity, within exclusion 10(a), the cover under the indemnity clause of the products liability insurance would be severely circumscribed. The indemnity clause would not respond unless Jobs Engineering's legal liability to pay was not attributable to its negligence or other breach of duty owed by it in a professional capacity, but arose on some other legal basis. The parties cannot have intended such an uncommercial and unreasonable result, and it is not a construction which the language of the policy unequivocally requires.... I consider that exclusion 10(a) is limited, in the context of the products liability cover, to claims arising out of breaches of duty owed by Jobs Engineering to persons who have retained it to perform work or services in the course of its business. The exclusion does not extend to breaches of duty owed to third parties who may suffer foreseeable loss or damage as a result of negligent acts or omissions by Jobs Engineering in designing, manufacturing or supplying machinery and equipment, including the negligent failure to give advice of the kind which it should have given to V & D Ridolfo. My construction of exclusion 10(a) is consistent with the evident object of the products liability cover, namely, to provide indemnity, of real and not negligible value, in respect of claims for personal injury and property damage caused by defective goods and property designed and manufactured by Jobs Engineering, and put into circulation within Australia.

The above passages are quoted in *Chubb*, see [144] onwards. The approach in *Fitzpatrick* was also endorsed by the NSW Court of Appeal in *Vero Insurance Ltd v Power Technologies Pty Ltd* [2007] NSWCA 226; (2007) 14 ANZ Insurance Cases 61-745 where Beazley P in the majority reasoned that the approach in *Fitzpatrick* (and followed in *Vero*):

... enables the policy to provide the indemnity which the parties undoubtedly intended the policy to have. To adopt a different construction would have significantly undermined the commercial purpose of the policy.: *Vero* at [148] – [150].

Similar reasoning was adopted by the full court in *Chubb* at [149].

3.4 Insurance Contracts Specifically

Construction of an insurance contract may call for different treatment of exclusion clauses, to those contracts that are not insurance contracts, as was stated by Kirby J in *McCann v Switzerland Insurance Australia Limited* [2000] HCA 65 at [4]:

Notwithstanding the primary duty of courts to give meaning to the words in an insurance policy, it has been recognised that, in cases of ambiguity, a “liberal approach” will generally be adopted in the construction of insurance contracts.

See also *Malamit Pty Ltd v WFI Insurance Ltd & Ors* [2016] NSWSC 1306 at [29].

Indeed, the Full Court in *Chubb*, citing the Full Court’s decision in *Todd v Alterra at Lloyds Ltd (on behalf of the underwriting members of Syndicate 1400)* [2016] FCAFC 15 at [35]-[44], identified the difference between a contract of insurance and a contract of guarantee and indemnity as being significant, and determined not by reference to the elements of the contract, but rather the purpose and character of the arrangement (*Chubb* at [101], where inter alia the court quotes authorities speaking to the “social” purpose of insurance contracts). A succinct statement of the correct approach to interpreting and construing insurance contracts is set out in *Chubb* at [103]-[104] as follow:

Justice Beach delivered a separate judgment in *Todd*. At [71]–[77], his Honour stated several construction principles in respect of policies of insurance as follows:

- (a) The policy must be read and construed as a whole (at [71]);
- (b) Textual analysis is to be given primacy and words and their use must be construed in context and not in a vacuum. Uncertainty and ambiguity in the words used may only be ascertainable once context is first appreciated (at [72]); and
- (c) In construing the policy, the commercial purpose or object to be secured by the policy must be considered (at [76]).

We agree with his Honour’s remarks.

3.5 Nature of the Breach

There are various decisions suggesting that the nature of the breach is relevant to the construction of the exclusion clause that the court will endorse: the more serious or ‘fundamental’ the breach, the less likely that the court will construe the clause in favour of the proferens (see for instance *Smeaton Hanscomb & Co. Ltd v Sassoon I. Setty, Son & Co. (No. 1)* [1953] 2 Lloyd's Rep. 580).

However, in *Nissho Iwai Australia Limited v Malaysian International Shipping Corporation* [1989] HCA 32; 167 CLR 219 the High Court held that an exclusion clause may apply to an event that would defeat the main object of the contract:

... the nature of [the events stipulated in the exclusion clause] may nevertheless give rise to the inference that the clause was intended to apply to those events even when they occur in circumstances which defeat the main object of the contract...

3.5.1 Deliberate Breach

An exemption clause cast in general limitation terms will not cover a breach of contract that is deliberate: see the discussion in *Charles Delius Somerville Alexander (t/as Minter Ellison) v Perpetual Trustees WA Limited (ACN 008 666 886) and Perpetual Trustee Company Limited (ACN 000 001 007)* [2001] NSWCA from [58] onwards, although this aspect was not necessary for the conclusion in that case.

However, as is noted by *Cheshire and Fifoot Law of Contract*, 11th Australian Edition, page 539, the application of presumptions or rules of construction may be seen, in light of the High Court's decision in *Darlington* as questionable; instead, arguably primacy should be given to the plain construction of the clause according to the natural and ordinary meaning.

4 Excluding or Limiting Certain Heads of Damage

4.1 What to Note When Drafting

A strong exclusion or limitation of liability clause would address the following:

- 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;
- Exclude or limit 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',loss;
- Exclude or limit liability for types of work, supplies or events outside of the parties' area of expertise;
- Negate the *contra preferentum* rule;
- Where liability cannot be excluded:
 - limit it to resupplying the services or goods or cost of doing so; or
 - provide alternative monetary, and where appropriate time, limits to liability;
- apply the above exclusions or limitations for the benefit of the contracting party and its agents, representatives, officers and employees.

It should also provide an indemnity (discussed elsewhere in this paper) for the benefit of the party insofar as the party may become liable to third parties where it would not become liable to the principal.

Further, if there is a particular aspect of the context of the agreement – or the parties’ dealings in coming to the agreement – then the safer course is to draft the exclusion clause with a reference to that context. An explicit reference is the only way to ensure that a Court later called on to quell any dispute will have taken heed of it.

4.2 Direct Loss v Indirect Loss

A typical form of exclusion clause that will make its way into a commercial contract will be an exclusion for “consequential loss” arising from a breach or similar carve outs. It has been said that:

"[d]irect damage is that which flows naturally from the breach without other intervening cause and independently of special circumstances, while indirect damage does not so flow... indirect loss or damage is simply loss or damage which flows other than naturally from the breach, or which is related to the breach only because of some intervening cause or special circumstance.": see Atkinson J in *Saint Line Ltd v Richardsons, Westgarth & Co Ltd* [1940] 2 KB 99 at 103.

In *Macmahon Mining Services v Cobar Management* [2014] NSWSC 731, McDougall J, in considering the above phrasing in which one of the parties sought to rely on an exclusion for consequential loss stated:

To my mind, that observation [of Atkinson J] has great appeal. It looks to the causal relationship between the breach and the damage, not (as the rule in *Hadley v Baxendale* tends to do, at least in its application if not in its original formulation) to questions of remoteness. ...

If one applies the words of Atkinson J to the present case then indirect loss or damage is simply loss or damage which flows other than naturally from the breach, or which is related to the breach only because of some intervening cause or special circumstance.

While the ordinary rules concerning contractual interpretation apply, there appears to be some lack of uniformity in the approaches taken across state borders to the meaning to be attributed to these clauses, and in particular, whether the notion of consequential loss as referred to in an exclusion clause is to mirror the second limb of *Hadley v Baxendale*.

In the Victorian decision of *Environmental Systems Pty Ltd v Peerless Holdings Pty Ltd* [2008] VSCA 26, the meaning of consequential as used was determined to be that which an ordinary reasonable business person would consider consequential, at [93] Nettle JA (as his Honour then was) writing for the Court:

In my view, ordinary reasonable business persons would naturally conceive of ‘consequential loss’ in contract as everything beyond the normal measure of damages, such as profits lost or expenses incurred through breach...It is more likely in this context that they intended the expression to have its ordinary and natural meaning [than one argued for in older authority]. ... Read in the light of the contract as a whole, and giving due weight to the context in which the clause appears, including the nature and object of the contract, I see no ambiguity which as a matter of principle would warrant a departure from that view. It follows as I see it that, although the judge’s approach in this case was in accordance with the English cases, it was not correct to construe ‘consequential loss’ as limited to the second rule in *Hadley v Baxendale*.

To contrast, in the South Australian decision of *Alstom Ltd v Yokogawa Australia Pty Ltd & Anor (No 7)* [2012] SASC 49, four years after *Environmental Systems* (while adopting in general the approach of the Victorian Court of Appeal in *Environmental Systems* at [289]) offered a slightly different, and broader, approach at [281] to [290]:

To limit the meaning of indirect or consequential losses and like expressions, in whatever context they may appear, to losses arising only under the second limb of *Hadley v Baxendale* is, in my view, unduly restrictive and fails to do justice to the language used. The word “consequential”, according to the Shorter Oxford English Dictionary means “following, especially as an effect, immediate or eventual or as a logical inference”. That means that, unless qualified by its context, it would normally extend, subject to rules relating to remoteness, to all damages suffered as a consequence of a breach of contract. That is not necessarily the same as loss or damage consequential upon a defect in material where other remedies are also provided....

The expression “indirect ... or consequential loss” appears, in this case, as part of a freestanding and powerfully expressed exclusion clause. It is not affected by the immediate presence of any concession as to liability which it might qualify, although it must be read against the background of the qualified exposure of YDRML to the exclusive remedies of Liquidated Damages and reimbursement of Performance Guarantee Payments. The Article in question was intended to operate in respect of potential liability for loss incurred by Alstom, which was caused by a breach of contract by YDRML in circumstances other than those giving rise to the payment of Liquidated Damages and reimbursement of Performance Guarantee Payments. The words must be given their ordinary and natural meaning. In those circumstances any loss consequential or following, immediate or eventual, flowing from a breach of contract by YDRML is excluded from recovery by Alstom.”

To contrast further, in 2013, the Western Australian decision of *Regional Power v Pacific Hydro [No 2]* [2013] WASC 356, offered the position that consequential loss exclusion clauses should be construed on the circumstances of the case according to the natural and ordinary meaning stating at [88] to [96]:

In *Electricity Generation Corporation t/as Verve Energy v Woodside Energy Ltd* ... Murphy JA said: “[I]n my view the nature and scope of [the clause] is to be determined by reference to its proper construction rather than by the application of the suggested general rule. The proper approach to construction is set out in *Darlington v Delco*.

...

To reject the rigid construction approach towards the term 'consequential loss' predicated upon a conceptual inappropriateness of invoking the *Hadley v Baxendale* dichotomy as to remoteness of loss, only then to replace that approach by a rigid touchstone of the 'normal measure of damages' and which always automatically eliminates profits lost and expenses incurred, would pose equivalent conceptual difficulties. Accordingly, I doubt whether the [93] observations in *Environmental Systems* were intended to carry any general applicability towards establishing a rigid new construction principle for limitation clauses going much beyond the presenting circumstances of that case.

This approach, accounting also for the approach in *Regional Power* seems to be the preferred approach of at least one more recent decision. In *Sherrin Hire Pty Ltd v Tidd Ross Todd Ltd (No 2)* [2016] FCA 891, Edelman J (as his Honour then was) at [20] states:

... although particular contractual contexts might not often illuminate the meaning of words such as “consequential loss”, the appropriate starting point might be the particular contractual context because the same words can mean different things in different contexts. These are matters best determined after trial. Australian cases have emphasised that construction of consequential loss clauses should not occur in a vacuum.

It seems, therefore, that context counts but as a guide and, although MacDougall’s J decision in *McMahon* offers a simplified version of the approach to be taken to what is direct as opposed to consequential loss, it is not to operate as a heuristic that shuts out a proper analysis of terms in context.

4.3 Caps v Carve Outs

There is no general rule as to what level of financial cap will be effective. Some businesses seek to set the cap equal to the overall price of the supply. This has been accepted by the courts as reasonable in some cases, but not all. It is better to include the cap, and have the argument in court, than to not have the argument available to you.

4.4 Time to Percolate

A useful tool is to conclude the drafting of an exclusion clause and let it sit for some time. Do other work, or do something other than work, before returning to read the draft with fresh eyes. It always surprises how greater the insight – and ability to spot errors in reasoning (possibly spelling and grammar) and holes in the intended exclusion – becomes on a fresh read of a pleading.

5 Agreed Damages Clauses

An agreed damages clause is not an exclusion clause: *Suisse Atlantique Societe d'Armemet Maritime SA b NV Rotterdamsche Kolen Centrale* [1967] 1 AC 361 at 395, 411, 420-421 and 436; *Superfos Chartering AIS v NBR (London) Ltd (The Saturnia)* [1987] 2 Lloyd's Rep 43 at 45.

They are also known as liquidated damages clauses. A characteristic of such a clause is that they benefit one party only and are a popular way of dealing with the possibility of breach. The essence of them is that a party in breach of its obligations under a contract is obliged, by that contract, to pay a particular sum by way of compensation for that breach. The sum is fixed in advance and written into the contract.

The courts recognise the advantages of these clauses for both parties. These, combined with the general principle of freedom of contract, have led to a general view on the courts' part that these clauses should be upheld, especially in a commercial context where the parties are seen as free to apportion the risks between them.

However, an agreed damages clause which constitutes a penalty will not be enforceable. A number of pointers have emerged from the case law on the topic which must be taken into account when considering this issue. There are also a number of drafting points to follow which will help any such clause to be upheld.

The High Court described a penalty thus in *Andrews v Australia and New Zealand Banking Group Ltd* [2012] HCA 30 at [10] (footnotes omitted):

In general terms, a stipulation *prima facie* imposes a penalty on a party ("the first party") if, as a matter of substance, it is collateral (or accessory) to a primary stipulation in favour of a second party and this collateral stipulation, upon the failure of the primary stipulation, imposes upon the first party an additional detriment, the penalty, to the benefit of the second party. In that sense, the collateral or accessory stipulation is described as being in the nature of a security for and *in terrorem* of the satisfaction of the primary stipulation. If compensation can be made to the second party for the prejudice suffered by failure of the primary stipulation, the collateral stipulation and the penalty are enforced only to the extent of that compensation. The first party is relieved to that degree from liability to satisfy the collateral stipulation.

Two cases, by contrast, show the essence of how to draft for penalty issues:

- *Lachlan v HP Mercantile Pty Ltd* [2014] NSWSC 356 where there was a penalty because X was owed and a later payment increased it to the higher Y; and
- *Zenith Engineering Pty Ltd v Queensland Crane and Machinery Pty Ltd & Anor* [2000] QCA 221 where Y was owed but an early payment included a discount to the lower X.

Therefore, the sum payable must be payable because of breach, not because of some later increase from an agreed position.

6 Statutory Incursions

Attempts to contract out of liability may be frustrated by statute.

6.1 Generally

There are a number of statutes that may restrict the parties' ability to rely on an exclusion clause. Some of the more prominent ones are discussed below.

6.2 ACL: Generally

The *Australian Consumer Law* (set out in Schedule 2 to the *Competition and Consumer Act 2010* (Cth) (hereafter, the 'ACL')) provides certain statutory limits on the power of parties to carve out liability that may befall one part or another. Relevant sections include s 64 which provides that certain rights and remedies under the ACL cannot be excluded, with the consequence that such attempts may be void. For relevant rights set out in the ACL itself, see ss 54, 60, 64, 261 *inter alia*.

Specifically, s 64 prohibits contractual provisions which 'purports to exclude, restrict or modify' the 'application' of any of the provisions which impose consumer guarantees in relation to contracts for the supply of goods or services to consumers, any right under the regime and any 'liability' for failure to comply with a consumer guarantee. Further, the prohibition extends to a provision which 'has the effect of excluding, restricting or modifying' any of the above. Therefore, even apart from the fact that the obligations are imposed by the ACL by way of statutory duty (rather than implied term), s 64 appears to leave no room for the parties to agree to a standard of the duty differing from that applicable under any of the consumer guarantees imposed by the regime.

But s 64A of the ACL does permit a supplier to limit its liability in certain described ways in relation to most of the consumer guarantees imposed by the regime. This does not, however, apply where the goods or services are of a kind ordinarily acquired for personal, domestic or house use or consumption.

6.3 ACL: Misleading and Deceptive Conduct

The Victorian Supreme Court relatively recently considered whether exclusion or limitation clauses apply to claims under s 18 of the ACL, namely for misleading and deceptive conduct: *Brighton Australia Pty Ltd v Multiplex Constructions Pty Ltd* [2018] VSC 246.

Up until that decision, a number of NSW decisions had suggested procedural imitations could apply, for instance time limits or monetary caps:

- In *Owners SP 62390 v Kell & Rigby* [1009] NSWSC 1342 McDougall J held that there was no reason why the limitation of liability clause imposing a time limitation on making a claim could not be applied to a misleading and deceptive conduct claim, despite the fact that the ACL (and formerly s 52 of the *Trade Practices Act 1974* (Cth)) had its own time periods. His Honour held both time periods would apply, with the earlier in time operating as a restriction alone before both would do so.
- In both of *Firstmac Fiduciary Services Pty Limited v HSBC Bank of Australia Limited* [2012] NSWSC 1122 and *Lane Cove Council v Michael Davies & Associates* [2012] NSWSC 7272 Sackar J held that the exclusion clause which imposed a limit on the time for any claims to be made was valid and operative.

In a sense foreshadowing the decision in *Brighton*, in *Omega Air Inc v CAE Australia Pty Ltd* [2015] NSWSC 802, Ball J held that allowing the procedural limitations leads to the inevitable conclusion that the Court will be called upon to draw a line at what is reasonable and what is not. E.g. is \$1 limit, or a time frame of 24 hours, to draconian?

In *Brighton*, Riordan J cited the above cases, acknowledged that he was departing from McDougall and Sackar JJ, but was consistent with Ball J, and held that the s 236(2) limit of six months was operative and a contractually short period was not.⁴

The position as it now stands seems best summarised by Abadee DCJ in *Junair Spraybooths ANZ Pty Ltd v Rydalmere Prestige Smash Repairs Pty Ltd* [2019] NSWDC 367 at [303]:

In my view, if it was necessary to decide, the observations of McDougall J and Sackar J, which were primarily directed to time bar provisions (arguably, procedural in nature) should not, with respect, be taken to support the view that a contractual limitation on the monetary amount that can be recoverable can (irrespective of whether it would be contrary to public policy) exclude or limit the monetary amount recoverable in an action for damages for contravention of s 18 of the *Australian Consumer Law*. That is not, in terms, what either McDougall J or Sackar J, in their decisions said. Such view would appear to be antithetical to the object (s 2) of the *Competition and Consumer Act 2010* (Cth) (in which s 236, and the other provisions of the *Australian Consumer Law* combine to comprise a Schedule) of enhancing the welfare of Australians through the provision for consumer protection. Section 236 needs to be construed with this object in mind [27]. As with Ball J, I find it difficult to draw the line between a contractual provision which could limit and that which would exclude altogether a remedy for a substantive right conferred by statute.

⁴ *Brighton* was later cited by Sackar J in *WLD Practice Holdings Pty Ltd, in respect of the WLD Practice Holdings Trust v Sara Stockham and Anor* [2020] NSWSC 395 at [25].

Absent any intermediate appellate authority quelling the issue, Judge Abadee's position summarises the point well.

6.4 Insurance

The *Insurance Contracts Act 1984* (Cth) at s 54 also may affect an attempt to exclude liability in an insurance contract, in that it may bar an insurer from refusing a claim on the basis of an act of the insured which did not cause or contribute to the loss: s 54(3)

6.5 Unfair Contracts

The *Contracts Review Act 1980* (NSW) affords a Court various powers to restrict a contract – including declaring it void in whole or in part (s 7), or the use of various ancillary relief measures (s 8 and Schedule 1) – where it considers it unfair or otherwise just to intervene.

It can be applied in circumstances otherwise governed by an exclusion clause.

7 Case Law Update

It is convenient to consider the decision in *Chubb* before turning to more recent cases.

7.1 Chubb

In *Chubb*, a contract of insurance whereby Chubb provided amongst other protections, directors and officers liability insurance to RBG and associates, included an exclusion clause. The clause provided in exclusion in respect of loss which was occasioned by an act or omission in the rendering of, or actual or alleged failure to render, any “professional services” to a third party.

The critical question before the Full Court was what was meant by “professional services”.

Prior to the contract of insurance, RBG’s wholly owned subsidiary (Reed) had entered into a design contract with 470 St Kilda Road Pty Ltd (‘St Kilda’) as a part of the Leopold project development.

The contract arrangements between Reed and St Kilda involved a Reed employee entering progress payment claims with St Kilda which were to be verified by statutory declaration. One of these progress claims was disputed by St Kilda, and was subsequently the subject of proceedings in which St Kilda claimed against Reed, and one of its employees (Robinson), for misleading and deceptive conduct, and separately, negligence. The employee, Robinson, denied the claims and cross-claimed against Chubb.

Chubb argued the exclusion clause of the contract carved out the conduct of Robinson as an act “in the rendering of, or actual or alleged failure to render any professional services to a third party”. It is worth noting Reed did not have professional indemnity insurance with Chubb.

At first instance, the Court found that the conduct of Robinson was not covered by the exclusion clause and Chubb remained liable to cover under the contract of insurance.

The director and officer insurance policy by its terms covered ‘Executives’ which was defined to mean, “any natural person who was, now is or shall be a company director, including for the avoidance of doubt, a de facto director or shadow director, officer or the holder of an equivalent position in any jurisdiction”. It was accepted that Robinson was an “insured person” for the purposes of the policy, although not as an officer of the company, by this clause or by the definition that might be applied from the *Corporations Act 2001* (Cth).

The central focus of the Full Court was the construction of the exclusion clause, which essentially carved out liability for:

- (a) any act committed;
- (b) in the rendering of;

(c) professional services to a third party
(the above is the author’s abbreviated break-down. For the clause as replicated in the judgment, see para [79], and for the Court’s abbreviated break-down see [126]).

The core complaint in the case (as set out at [113] and surrounding) was that the Court at first instance, and against the weight of authority, in substance applied the *contra preferentum* rules as a “first point of reference” (where they said there was no ambiguity) as opposed to a “last resort”.

In answer to Chubb’s submission “professional services” should be understood in light of industry practice, the Court stated at [124]:

We do not agree that, in every case, the scope of an exclusion in respect of professional services in a D&O policy must correspond with the scope of cover provided by the commonly used insuring clause in policies which provide professional indemnity cover. That is far too general a statement and ignores the importance of the principles explained by the High Court in *Delco* and in *Selected Seeds*.

The Court accepted a submission from Chubb that the appropriate interpretation of the exclusion clause was to read, in effect:

“... in the rendering of, or actual or alleged failure to render, any professional services to a third party.”

as

“... [in the course of] rendering of, or actual or alleged failure to render, any professional services to a third party.”

As stated by the Court at [127] (emphasis added):

Read in this way, the exclusion would apply not only to loss in respect of a claim for an act or omission that constituted or comprised the actual rendering of a professional service or professional services to a third party but also an act or omission which **was merely a step** which formed part of the rendering of such a service or such services.

The Court’s conclusion on the essential question in the case was set out at [150]-[152], and [163]:

It seems to us that the expression “professional services” in the relevant exclusion clause in the present case means services of a professional nature furnished by RBG or one of its subsidiaries involving the application of skill and judgment by the person or persons who carried out the relevant activities on behalf of RBG or one of its subsidiaries being services which fall within the scope of a vocational discipline which is generally regarded as a profession...

Thus, in our view, the professional services exclusion in the D&O policy in the present case operates to exclude from the cover provided under that policy, cover in respect of liability incurred by an insured under the policy (viz the relevant companies and/or their executives) for loss suffered by others as a result of acts or omissions on the part of such executives which acts took place in the course of the rendering of services (which services have the requisite professional character as explained at [150] above) by one or more of the companies in the Reed group of companies or their executives to a third party...

This interpretation is consistent with her Honour's interpretation of the clause... her Honour held that the obvious purpose of the exclusion was to exclude activities that are truly professional in nature, such as architectural design, engineering, surveying and quantity surveying. The clause was not intended to apply to the routine activities of Reed or of its executives. The provision of progress claims under the D&C Contract were routine activities and did not constitute the rendering of a professional service to St Kilda or to anyone else....

... [W]e do not consider that the making of the statutory declaration by Mr Robinson and his authorising it to be submitted to St Kilda constituted the rendering of any service to St Kilda either by Reed or by Mr Robinson. Rather, those acts on Mr Robinson's part were acts done on behalf of Reed in the proper discharge of the contractual obligations owed by it to St Kilda in respect of claims for payment made under the D&C Contract."

Also in issue in that case was whether project management was in fact a profession, such that work done in the course of project management were professional services. The court concluded that it was not a profession: see *Chubb* at [158].