

Allocation, allocation, allocation

Limitation of liability and the liability cap are often only agreed at the last moment in contract negotiations. Bridget Treacy examines risk allocation and outlines drafting considerations for buyers

In a services contract there is a dynamic relationship between service, price and risk. But for many projects, early discussions focus on the service being purchased and the amount being paid, so that the project becomes the "£40 million payroll outsource" (or similar). Both price and service will be influenced by a third factor, risk; yet risk allocation seldom features expressly in these early discussions.

It is important to identify the elements of risk at the outset. Risk and its allocation will then inform the price negotiations. Buyers should be aware that, even if they do not formally consider risk allocation at an early stage, their suppliers will certainly do so to quote for the project.

At the drawing board

Risk allocation must, therefore, be reflected in the contract drafting. Aspects of risk will be covered in the "limitation of liability" clause, but informed suppliers will ensure that risk allocation and other provisions which limit or exclude liability appear throughout the contract, usually without much fanfare.

When it comes to drafting, a variety of devices may be deployed:

- Services should be clearly defined
- The buyer will seek express representations about the services and service delivery (usually in the form of warranties)
- The buyer will seek specific remedies (perhaps including an indemnity) in the event of breach of any representations. The seller will propose a variety of devices to limit liability, including exclusions of it, acceptance within constraints and insurance

All too often, particularly in the context of IT or other technical services, the services description is left to the technical

team. This is an abdication of responsibility as frequently the services schedules are not then drafted so as to import legally enforceable obligations. Contract negotiations may be won or lost in the detail of the schedules, sometimes without a party realising the nature or extent of concessions made.

Warranties and indemnities

A more recent feature of services agreements is the inclusion of warranties and indemnities. "Warranties" are contractual terms which are of less significance than "conditions", so that a breach of warranty does not give rise to a right to terminate the contract, but merely a right to seek damages. It is now common to see warranties in contracts for services, backed by specific remedies for breach. A further development, which mirrors the use of warranties in corporate finance transactions, is to see specific indemnities which will attach to a breach of warranty.

In determining whether to insist upon an indemnity, a buyer should consider what benefit it would add beyond the usual contractual remedies. The usual benefits of indemnities relate to remoteness of damage and mitigation of loss; in other words, when enforcing an indemnity, a party does not need to establish proximity between the loss and the breach, or take steps to mitigate loss. However, historically indemnities were available for claims in debt rather than for other breaches of contract. There are signs that where the indemnity covers a general breach of contract, a court might expect a claimant to mitigate its loss.

Limitation of liability

Some types of loss cannot be excluded. The key legislative provision here is the Unfair Contract Terms Act 1997 which prohibits absolutely the exclusion of losses arising from death or personal injury, and losses arising from breach of the

statutory implied terms as to title and no encumbrance.

Other types of loss may be excluded provided the exclusion is reasonable (see box). Losses arising from negligence and breach of contract where standard terms are used must be reasonable.

Where does this leave buyers? Risk should be identified early and factored into price discussions. Buyers should insist on detailed services descriptions, clearly setting out responsibilities. Well-considered warranties with clear remedies and/or indemnities in support can provide a powerful and practical remedy. Buyers should also analyse the entirety of the limitation of liability provisions, not just those labelled as such.

Checklist

The test for "reasonableness" is described in the Unfair Contract Terms Act (section 11(1)). Exclusion clauses are construed strictly against the party seeking to rely on them, so must be carefully drafted. Relevant cases and their references: *St Albans City and DC v International Computers Limited* [1995] FSR 686 (QBD), *South West Water Services Limited v International Computers Ltd* [1999] ITCLR 439 and *Pegler Limited v Wang (UK) Limited* [2000] ITCLR 617; 70 Con LR 68

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This article does not provide a complete statement of the law. It is intended merely to highlight issues which may be of general interest and does not take account of individual circumstances. We would not recommend acting solely on its basis.

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