LIABILITY, LIQUIDATED DAMAGES AND INDEMNITY PROVISIONS

DLA Piper Commercial Contracts Webinar Programme

September 2016
## Agenda

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## Speakers

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Introduction
Liability section will cover:

- Basics of contractual liability
- Direct and indirect loss – meaning?
- Caps and exclusions – what is permissible/trends/unlimited liability
- Jurisdiction update on recent cases/laws
Contractual Liability: The Basics

- Australia
- UK
- Hong Kong
  - Common law jurisdictions. Therefore breach of contract = claim for damages
  - NB:
    - Contra Proferentem
    - Other contractual remedies
    - Damages = compensation for loss, NOT punitive
    - Duty to mitigate
    - Equitable remedies
- China - a bit different….
Refresher: direct + indirect losses: Starting point, foreseeable loss is recoverable

Arises naturally (i.e. according to the usual course of things) from the breach

Reasonably supposed to have been in the contemplation of both parties at the time they made the contract as the probable result of the breach

Direct

Special or Indirect or Consequential

"Too remote"

Objectively foreseeable

Subjectively foreseeable

Note:

- "Special" and "consequential" = indirect
- Loss of profits can be either direct or indirect
Caps and exclusion clauses

- The inclusion of liability provisions that seek to limit the liability and exposure of parties for certain types of claims and losses is common across most markets.

- There are, however, differences in legislative regimes (particularly for contracts with consumers) and market norms around some aspects of liability limitation and exclusion provisions. Some considerations:
  - can liability be excluded/limited?
  - fixed caps vs 'multipliers' tied to contract value (NB: care with paid and payable)
  - types of loss /claims which are carved out from liability limitation and exclusion provisions (e.g. third party IP claims)
  - loss of profits/revenue/goodwill/business/savings/data/ etc…
  - consumer protection legislation (eg, Australian Consumer Law, Consumer Rights Act 2015 (UK))
Unlimited liabilities

- Mostly a matter of convention and negotiation.
- Categories have been progressively expanding.
- Categorisation:
  - Death and personal injury from negligence
  - Fraud
  - Breaches of intellectual property rights
  - TUPE/ARD liabilities (in Europe)
  - Breaches of confidentiality
  - Data protection
  - Wilful default
  - IT security
  - Breaches of law/regulation
  - Specified clauses

- Always
- Common
- More aggressive
The formulation and interpretation of 'consequential loss' exclusion clauses has been in a state of flux in recent years as a result of evolving case law including *Peerless v Environmental Systems* [2008] VSCA 26.

One (customer-friendly) approach is to 'write back' in those losses which *Peerless* excluded:

*To the extent permitted by law, the liability of a party under this agreement will not include any consequential loss or damages. However, the foregoing does not preclude the recovery by a party of any costs, expenses, losses or damages to the extent they may fairly and reasonably be considered to arise directly and naturally, that is according to the usual course of things, from the breach or other wrongful act or omission giving rise to the relevant liability.* (emphasis added)
Liability - UK

- Some statutory teams cannot be excluded (e.g. title – SOGA 1979) OR forms of liability (Death & PI and fraudulent misrepresentation)
- Indirect/consequential broadly follows original rules
- Indirect exclusion including… loss of profit… etc
- Legislation protecting consumers and businesses - Reasonableness and UCTA; Consumer Rights Act 2015
- Interesting recent updates:
  - *Saint Gobain* - v- *Hillmead Joinery* (2015) - Standard terms; UCTA; and reasonableness
Liability – Hong Kong

- Follow the English law principles when drafting
  - Reasonable foreseeability of loss and knowledge of special circumstances
  - Direct losses
  - Indirect/consequential losses
  - Specific heads of loss
- Certain liabilities cannot be excluded – fraud, personal injury/death
- Reasonableness
  - Control of Exemption Clauses Ordinance (Cap. 71)
  - Unconscionable Contracts Ordinance (Cap. 458)
- Limitation period
  - Limitation Ordinance (Cap. 347)
Liability – People's Republic of China

- PRC Contract Law of 1999
  - plus interpretation from case law

- Liability
  - Article 112: liable to pay damages for other loss sustained, notwithstanding subsequent performance or cure of non-conforming performance
  - Article 113: damages equal to the loss that \textit{was foreseen or should have been foreseen} by breaching party at the time of conclusion of the contract
  - Article 119: innocent party to take appropriate measures to prevent further loss

- Invalidity of certain exclusion clauses (Article 53):
  - Personal injury
  - Losses caused by deliberate acts or gross negligence

- Limitations/exclusions - fairness/reasonableness

- Drafting tips
Liquidated damages
Liquidated damages

- Liquidated damages provisions in a contract fix a pre-agreed sum payable as damages for a party's breach of contract.

- Purpose and advantages of liquidated damages clauses:
  - Acts as a performance incentive.
  - Overcomes difficulty in assessing common law damages.
  - Easily and quickly enforced.
  - No proof of loss required.

- However, it is important to ensure that liquidated damages are a genuine pre-estimate of the loss. Otherwise the liquidated damages provision may be a penalty and unenforceable.

- The classic case is *Dunlop Pneumatic Tyre Company Limited v New Garage and Motor Company Limited*. 
Liquidated damages – key principles

- 'The question as to whether a sum stipulated is penalty or liquidated damages is a question to be decided upon the terms and inherent circumstances of each particular contract, judged at the time of the making of the contract, not as at the time of breach'.

- 'It is not an obstacle to the sum stipulated being a genuine pre-estimate of damage, that the consequences of the breach are such as to make precise pre-estimation almost an impossibility. On the contrary, that is just the situation when it is probable that pre-estimated damage was the true bargain between the parties'.

Liquidated damages - Australia

- …the propounded penalty must be judged 'extravagant and unconscionable in amount'. It is not enough that it should be lacking in proportion. It must be 'out of all proportion' (Ringrow Pty Ltd v BP Australia Pty Ltd (2005) 224 CLR 656)

- Relief against penalties may be available where obligation to pay arose other than on a breach of contract (Andrews v ANZ Banking Group Limited (2012) 247 CLR 205)

- The most recent "bank exceptions fee" case found that credit card late payment fees were no penalties – the fees had a purpose other than punishment (including fixing the risk and reward over multiple transactions, and protecting ANZ's interests in ensuring customers made timely payments) and the fees charged were not 'out of all proportion' (Paciocco v ANZ Banking Group Limited (2016) HCA 2016)
Liquidated damages - UK

- *Makdessi* and *Parking Eye Ltd* [2015] – up to date position
  - Move away from "pre-estimate of loss"
  - Emphasis on primary and secondary obligation.
    - **Penalty** = a secondary obligation to impose detriment on contract breaker out of proportion to legitimate interest….
  - Favourable to customers!
Liquidated damages – Hong Kong

- Not yet followed *Makdessi* and *ParkingEye Ltd*
- 'Old' test still applies - whether the amount stipulated is a **genuine pre-estimate of loss**
  - compensatory
  - cannot be punitive
  - *Phillips (Hong Kong) Ltd v The Attorney General of Hong Kong* [1993] UKPC 3
Liquidated damages – China

- Allowed under PRC Contract Law of 1999
- Article 114:
  - If amount is below loss resulting from the breach, a party may petition the People's Court or an arbitration institution to increase the amount
  - If amount exceeds loss resulting from the breach, a party may petition the People's Court or an arbitration institution to decrease the amount
  - Breaching party shall pay liquidated damages and render performance
- Article 116: innocent party may only elect to apply the (1) liquidated damages clause OR (2) the deposit clause
- Interpretation II of the Supreme People's Court (2009) – Article 29:
  - if amount exceeds loss actually incurred by 30% → deemed as "significantly higher than the losses incurred"
Indemnities
Indemnities in a nutshell

What is an indemnity?
- a promise made by A to compensate B if B incurs liability under a specific type of claim

What is its effect?
- elevates the claim so that A is exposed to more financial risk/B can enjoy increased compensation for the relevant claim
- in practice this elevation can be less dramatic than sometimes thought
## Current Market Practice

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<th>Common</th>
<th>More aggressive</th>
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Indemnity – China

- Inclusion of an indemnity clause in China may not achieve the intended purpose.
- In practice, sue for damages under PRC Contract Law of 1999:
  - Article 113 – Loss that **was foreseen or should have been foreseen** by breaching party at the time of conclusion of the contract.
  - Article 119 – Innocent party to take appropriate measures to prevent further loss.
- More sensible approach:
  - Set out expressly in the contract how damages will be calculated.
- Punitive damages allowed under certain circumstances, e.g.:
  - Fraudulent proprietor shall pay compensation 3 times the price of the goods or services purchased by a consumer (Article 55, Law on Protection of the Rights and Interests of Consumers).
Conclusion
Resources –
Global Contract Laws and Going Global Guide

- **Global Contract Laws** ("GCL") is DLA Piper’s online "handbook" that provides users with summary answers on day-to-day contract law questions that international businesses face when trading in international jurisdictions. GCL covers 110 topics in 19 different topic areas (e.g. laws regarding e-commerce, liability, disputes, agency and distribution) across 20+ countries. It is useful for a quick summary of the law in a particular area for a country or for comparing countries.
  
  *Take a look at:* [http://www.dlapipercontractlaws.com](http://www.dlapipercontractlaws.com)

- Our **Going Global Guide** covers the corporate basics in 30 key jurisdictions across the Americas, Asia Pacific, Europe and the Middle East. We touch on a wide range of corporate issues relevant to joint ventures including establishing a corporate presence and choice of entity, liability considerations, tax presence and tax filings, capital requirements, the formation process, director, officer and shareholder requirements, registration processes, office lease processes and possible exit strategies.
  
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