

Exclusive Remedies Clauses – Note and Sample Wording

Introduction

It is common for contractors to request the inclusion of an exclusive remedies clause in a contract. However, from the perspective of an owner, the danger of an exclusive remedies clause is that it may prevent the owner from recovering any type of damages not specifically provided for in the contract.

This note examines the use of an exclusive remedies clause and the steps that should be taken by an owner to protect its position if it must include an exclusive remedies clause in a contract. In particular, we focus on protections for the owner if the liquidated damages regime is held to be invalid and unenforceable.

Legal position

In common law jurisdictions a contract is conclusive evidence of the agreement between the parties to the contract. If a party clearly and unambiguously agrees that their only remedies are those within the contract, they will be bound by those terms. However, courts in a number of common law jurisdictions have been reluctant to come to this conclusion without clear evidence of an intention of the parties to contract out of their legal rights¹. This means if the common law right to sue for breach of contract is to be contractually removed, it must be done by very clear words.

Contractor's perspective

The main reason for a contractor insisting on an owner being subject to an exclusive remedies clause is so that it can have certainty about its potential liabilities. The preferred position for a contractor will be to confine its liabilities to what is specified in the contract. For example, an agreed rate of liquidated damages for delay and, where relevant, underperformance of the plant or facility. A contractor will also generally require the amount of liquidated damages to be subject to a cap and for the contract to include an overall cap on its liability.

Owner's perspective

The preferred position for an owner is for it not to be subject to an exclusive remedies clause. An exclusive remedies clause limits the owner's right to recover for any failure of the contractor to fulfill its contractual obligations to those remedies specified in the contract. For this reason, an exclusive remedies clause is an illogical clause to include in a contract from the perspective of an owner because it means that the owner has to draft a remedy or exception for each obligation - this represents an absurd drafting position.

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For example, take the situation where the contract does not have any provision for the recovery of damages other than liquidated damages. In this case, if the contractor has either paid the maximum amount of liquidated damages or delivered the facility in a manner that does not require the payment of liquidated damages (i.e. it is delivered on time and performs to specification) but subsequent to that delivery the owner is found to have a claim, say for defective design which manifests itself after completion, the owner will have no entitlement to recover any form of damages as any remedy for latent defects has been excluded.

The problem is exacerbated because most claims made by an owner will in some way relate to performance of the plant or facility and performance liquidated damages were expressed to be the exclusive remedy for any failure of the plant or facility to perform in the required manner. For example, any determination as to whether the plant or facility is fit for purpose will necessarily depend on the level and standard of the performance of the plant or facility.

In addition to claims relating to fitness for purpose, an owner may also wish to make claims for, amongst other things, breach of contract, breach of warranty or negligence.

The most significant risk for an owner in a contract is where there is an exclusive remedies clause and the only remedies for delay and underperformance are liquidated damages. If for whatever reason the liquidated damages regimes are held to be invalid, the owner would have no recourse against the contractor as it would be prevented from recovering general damages at law, and the contractor would escape liability for late delivery and underperformance of the plant or facility.

SUGGESTED DRAFTING

In contracts containing an exclusive remedies clause, the owner must ensure all necessary exceptions are expressly included in the contract. In addition, drafting must be included to allow the owner to recover general damages at law for delay and underperformance if the liquidated damages regimes in the contract are held to be invalid.

To protect the position of an owner (if liquidated damages are found for any reason to be unenforceable and there is an exclusive remedies clause), we recommend that the following clauses be included in the contract:

"[] .1 If clause [delay liquidated damages] is found for any reason to be void, invalid or otherwise inoperative so as to disentitle the Owner from claiming Delay Liquidated Damages, the Owner is entitled to claim against the Contractor damages at law for the Contractor's failure to complete the Works by the Date for Practical Completion.

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[].2 If [].1 applies, the damages claimed by the Owner must not exceed the amount specified in Item [] of Appendix [] for any one day of delay and in aggregate must not exceed the percentage of the Contract Price specified in Item [] of Appendix []."

These clauses (which would also apply to performance liquidated damages) mean that if liquidated damages are held to be unenforceable for any reason the owner will not be prevented from recovering general damages at law. However, the amount of damages recoverable at law will be limited to the amount of liquidated damages that would have been recoverable by the owner under the contract if the liquidated damages regime had not been held to be invalid. For this reason, the suggested drafting should be commercially acceptable to a contractor as its liability for delay and underperformance will be the same as originally contemplated by the parties at the time of entering into the contract.

In addition, if the contract excludes the parties right to claim their consequential or indirect losses, these clauses should be an exception to that exclusion. The rationale being that the rates of liquidated damages are likely to include an element of consequential or indirect losses.

Conclusion

The legal position is clear. If a liquidated damages clause is found to be invalid then, in the absence of an exclusive remedies clause in the contract, an owner will retain its right to recover general damages at law. For this reason, the preferred position for an owner is to not include an exclusive remedies clause in the contract which limits the remedies available to it for any breach or default of the contractor².

However, if a contractor insists on the inclusion of an exclusive remedies clause, the owner must, as a minimum, carve out specific exceptions to this position including the right to recover general damages at law if the liquidated provisions are found to be invalid for any reason.

Refer to Projects Update No.9 for an analysis of the legal position regarding the effect of liability caps in cases where the liquidated damages regime has been held to be invalid.

¹ Baese Pty Limited v R.A Bracken Building Pty Ltd (1990) 6 BCL 137.

² In some American jurisdictions an exclusive remedies clause may not be fatal to a claim at law if a liquidated damages regime is invalid.