

If the cap fits

James Farrell and Sophie Jones explore the lessons to be learned from a recent case on liability caps



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'Although the court will consider commercial common sense and the surrounding circumstances, its focus is first and foremost on the language used. The language used is something that contracting parties have control over, and they should exercise that control carefully.'

A recent Court of Appeal decision serves as a valuable reminder about the importance of using clear and precise drafting when negotiating provisions to limit liability under a contract.

In *Royal Devon and Exeter NHS Foundation Trust v Atos IT Services UK Ltd* [2017], the Court of Appeal considered the interpretation of a provision which purported to cap the liability of a provider of IT systems for defaults occurring at different stages of the contract. Jackson LJ (providing the leading judgment) disagreed with the interpretation of the clause in the court below. His interpretation of what he described as the 'homemade' clause, which had been negotiated by the parties, was the one which yielded 'the least bizarre consequences'.

Suppliers and customers alike will no doubt wish to avoid the costs and uncertainties of a similar dispute.

Background facts

The claimant NHS foundation trust engaged the defendant, Atos, to provide an IT system which would hold patient records online, so that clinicians could view and amend patients' records electronically. Atos agreed to provide health record scanning services and electronic document management (EDM) software and associated services.

The parties' contract was based on the standard form NHS Conditions of Contract for the Supply of IT Systems and the Provision of Associated Services, subject to certain amendments, and had a five-year term and a contract price of £4,939,207.

The project did not go well and there was a dispute as to who was responsible. The trust terminated the contract shortly before the end of its

term and issued proceedings in the Technology and Construction Court (TCC), claiming damages for alleged breaches of contract by Atos. Atos counterclaimed, asserting that the trust was responsible for the problems.

The liability cap

As is not uncommon in IT services and outsourcing contracts, the contract included a provision that purported to cap Atos's liability at differing levels depending on when the problem occurred, with the level of the cap declining as the contract progressed, presumably to reflect the parties' perceptions that the project risks would reduce over time.

Clause 8.1.2(b) provided that the aggregate liability of either party for all defaults (other than defaults resulting in direct loss of or damage to tangible property of the other party) 'shall not exceed the amount stated in Schedule G to be the limit of such liability'.

Paragraph 9.2 of Schedule G provided:

9.2 The aggregate liability of [Atos] in accordance with sub-clause 8.1.2 paragraph (b) shall not exceed:

9.2.1 for any claim arising in the first 12 months of the term of the Contract, the Total Contract Price as set out in section 1.1; or

9.2.2 for claims arising after the first 12 months of the Contract, the total Contract Charges paid in the 12 months prior to the date of that claim.

Paragraph 9.2 had been negotiated by the parties and was not part of

the standard form contract. Notably, the agreed wording ambiguously combined the concept of liability 'in aggregate' with the phrases 'for any claim' and 'for claims'.

Legal principles

The legal principles for interpreting a contract, which apply equally to a provision seeking to limit liability, are well established, thanks to a line of House of Lords, Supreme Court and

- commercial common sense, but it will disregard subjective evidence of any party's intentions
- If there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense (Lord Clarke in *Rainy Sky SA v Kookmin Bank* [2011], paras 21 to 30).

The central issue was the natural meaning of the words used, applying the test of a reasonable person who had all the background knowledge of the parties.

Court of Appeal authorities over the past half century:

- The court will seek to ascertain the parties' intentions by reference to:

... what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to mean...

(Lord Hoffmann in *Chartbrook Ltd v Persimmon Homes Ltd* [2009], para 14).

- The court will focus on the meaning of the words used in their documentary, factual and commercial context. In assessing the meaning of the language used, Lord Neuberger explained in *Arnold v Britton* [2015] (at para 15) that the court will consider:
 - the natural and ordinary meaning of the clause;
 - any other relevant provisions of the contract;
 - the overall purpose of the clause and the contract;
 - the facts and circumstances known or assumed by the parties at the time that the document was executed; and

- For limitation of liability provisions, there is no presumption against the parties having agreed to give up or limit their remedies for breach of contract. Provided that the words used are clear, the court will give effect to the commercial allocation of risk in the contract (Moore-Bick LJ in *Tradigrain SA v Intertek Testing Services (ITS) Canada Ltd* [2007], para 46; Briggs LJ in *Nobahar-Cookson v The Hut Group Ltd* [2016], para 19).
- Although it has been held that the words used must be clear and unambiguous in order to limit the liability of a party for their own wrongdoing (see eg *Dairy Containers Ltd v Tasman Orient Line CV* [2004], para 12), the courts are reluctant to find that a provision is void for uncertainty.
- The court will strive, where possible, to give effect to all terms agreed by the parties (Moore-Bick LJ in *Whitecap Leisure Ltd v John H Rundle Ltd* [2008], paras 21 to 22).

High Court

In the first instance decision in the TCC, O'Farrell J considered as a preliminary issue whether and, to what extent, Atos's liability was limited by para 9.2 of Schedule G.

Applying the legal principles on interpretation referred to above, she rejected the trust's submission that the

provision was not capable of being construed and should be declared unenforceable. Instead, she held that it imposed a single cap which, depending on the timing of the first default, would be either that set out in para 9.2.1 or that in para 9.2.2.

She considered that the words 'aggregate liability... shall not exceed' at the start of para 9.2 indicated that the parties intended to limit the total or composite liability of Atos. When read together with the word 'or' between sub-paras 9.2.1 and 9.2.2, she considered that this indicated that the parties intended to agree that one cap would apply.

She went on to say that if the provision were interpreted as providing multiple caps where there were multiple claims, this could lead to a liability cap that was multiple times the contract price if there were several defaults during the first year. Similarly, she said, that if there were one breach in the first 12 months and another, one day after the first 12 months, the level of the cap would approach double the contract price. She considered it 'very unlikely' that the parties would have agreed to such a term because 'the potential level of the cap would render it devoid of any real purpose'.

Court of Appeal

Both parties appealed. The trust appealed against the judge's decision

Arnold v Britton & ors [2015] UKSC 36
Chartbrook Ltd v Persimmon Homes Ltd [2009] UKHL 38
Dairy Containers Ltd v Tasman Orient Line CV [2004] UKPC 22
Nobahar-Cookson & ors v The Hut Group Ltd [2016] EWCA Civ 128
Rainy Sky SA & ors v Kookmin Bank [2011] UKSC 50
Royal Devon and Exeter NHS Foundation Trust v Atos IT Services UK Ltd [2017] EWHC 2197 (TCC); [2017] EWCA Civ 2196
Tradigrain SA & ors v Intertek Testing Services (ITS) Canada Ltd & anor [2007] EWCA Civ 154
Whitecap Leisure Ltd v John H Rundle Ltd [2008] EWCA Civ 429

that para 9.2 imposed one cap, rather than two. Atos's cross-appeal was asserted on the basis that, if the trust's appeal was successful, the last four words of sub-para 9.2.2 should be construed as meaning 'the date when that claim was notified'.

Jackson LJ and Lewison LJ in the Court of Appeal considered that the central issue for them to decide was the natural meaning of the words used, applying the test of a reasonable person who had all the background knowledge of the parties. Jackson LJ observed that both parties were well-resourced, commercial organisations with ready access to legal advice, such that there was no reason to depart from the natural meaning of the words used, once that meaning had been ascertained.

Jackson LJ agreed with the judge that para 9.2 did not impose multiple caps, for the reasons that she provided. However, he disagreed with the judge's view that the provision imposed one, rather than two caps.

In his view, the phrase 'aggregate liability' did not suggest one cap as it could also refer to the aggregate of the sums referred to in the sub-paragraphs below. He also said that the word 'or' could have a 'conjunctive' as well as a 'disjunctive' meaning. A good reason for using it (in the conjunctive sense) between sub-paras 9.2.1 and 9.2.2 was that the sub-paragraphs were mutually exclusive in that each referred to a discrete period and the two periods did not overlap.

In Jackson LJ's view, the language of para 9.2 pointed emphatically to there being two separate caps. For any default or defaults occurring during the first 12 months, Jackson LJ held that Atos's liability was capped at the contract price. For any default or defaults occurring during the remainder of the contract term, Atos's liability was capped at the amount of the contract charges paid in the preceding 12 months. If defaults occurred during both periods, both caps would apply: the cap of the contract price to defaults in the first 12 months, the cap of the last 12 months' charges to defaults in the subsequent period.

He considered that there was nothing surprising about this arrangement. Atos was expected to do the high-value work in the first year, when defaults could have very

expensive consequences. Lower value work would be undertaken in the subsequent years, with less expensive consequences. He accepted that this interpretation could still lead to some odd results, depending on when defaults occurred; however, he considered that the natural meaning, which yielded the least bizarre consequences, was that the provision imposed two separate caps.

Atos's cross-appeal was refused. The parties had already agreed that the words 'claim' and 'claims' at the beginning of each of the sub-paragraphs of para 9.2 meant 'default' or 'defaults', respectively. If the phrase 'claims arising' at the beginning of sub-para 9.2.2 referred to 'defaults arising', Jackson LJ considered that the phrase 'that claim' at the end of that sub-paragraph must be a reference to a default occurring, rather than a claim being communicated.

Negotiating clear and predictable limits on liability

The case serves as a useful reminder of the perils of negotiating clauses

which lack clear and precise wording. Limitation of liability clauses are often one of the most heavily negotiated parts of IT and outsourcing contracts and need careful consideration to ensure that they can be relied upon if defaults occur.

In interpreting a provision, although the court will consider commercial common sense and the surrounding circumstances, its focus is first and foremost on the language used. The language used is something that contracting parties have control over, and they should exercise that control carefully.

The more unclear the words of a provision are, the more ready the court will be to depart from their natural meaning. As the divergent views of the judges in the High Court and the Court of Appeal in this case demonstrate, a confusing clause can be interpreted in different ways. This can lead to uncertainty and the potential for costly and time-consuming legal disputes. ■

Practical tips

When drafting liability caps, the following points may assist:

- If parties decide to link their liability to the value of charges paid under their contract, they should be clear as to whether a cap will apply multiple times on a 'per claim' basis or only once as an 'umbrella' for all claims arising within a particular period.
- Parties should also consider how any connected claims would be treated, and whether the cap will be calculated by reference to charges *paid* or charges *payable* under the contract.
- Parties should ensure that they are clear as to whether any time boundary for defining the value of a cap is intended to be triggered by:
 - the date on which the claim first arose;
 - the date when the claim was first discovered by a party; or
 - the date on which the claim was formally notified by a party.
- Where there are several contracts governing a relationship, parties should be mindful of avoiding conflicting provisions purporting to cap or otherwise limit liability.
- Parties should consider whether to limit a cap to certain liabilities. For example, will it include payments made under an indemnity, liquidated damages, service credits or interest on any amount awarded by a court or arbitration tribunal?
- Parties should consider carefully the level of a cap. If the Unfair Contract Terms Act 1977 applies, eg in a business-to-business contract where one party is dealing on the other's standard terms, a term purporting to limit liability for breach of contract will only apply in so far as it is 'reasonable'.