The sky is the limit, or is it?

Important considerations in understanding limitations on liability.

THE CONSTRUCTION industry is a cornerstone of economic development, particularly in Ireland. However, the complexity of construction contracts and the inherent risks associated with construction projects necessitate a nuanced understanding of liabilities on construction projects and how they are managed.

Understanding Limitations on Liability

Limitations on liability are provisions that seek to cap or exclude the damages one party may recover from another in cases of breach of contract and/or negligence. These clauses seek to allocate risk and limit financial exposure. While parties may seek extensive limitations on their respective liabilities, doing so can result in prolonged negotiations. As such, to ensure efficient and effective negotiations, a balanced approach is advisable. Ultimately, where liability limitations are agreed in principle, they must be carefully drafted to avoid ambiguity as misinterpretation or broad exclusions can lead to disputes and any ambiguity will be construed against the drafter (by virtue of the contra proferentem rule).

Typically, limitations on liability in construction contracts can be categorised into three main types:

1. Exclusion Clauses

Exclusion clauses seek to eliminate liability for certain damages. To be enforceable, these clauses must be clearly incorporated and explicitly cover the relevant breach. In the 2015 Irish High Court case of Cavanagh v. Cavanagh, the court ruled that vague or poorly defined clauses may be unenforceable, underscoring the need for precise contract language.

Courts in other jurisdictions also interpret exclusion clauses narrowly, as demonstrated in Persimmon Homes v Ove Arup [2017] EWCA Civ 373. Exclusion clauses can often arise where a party is seeking to exclude liability for indirect or consequential losses, so it is worth considering what is meant by direct and indirect loss.

The seminal case of Hadley v. Baxendale (1854) 9 Ex 341 established a two-limb test for recoverable damages. The first limb (considered the "direct damages" limb) concerns damages that arise naturally from a breach, in other words, according to the usual course of things. In essence, these are losses that any reasonable person would foresee as a likely result of the breach. The second limb covers damages that do not necessarily arise naturally from a breach. In the absence of express drafting to the contrary, damages falling under this second limb are recoverable where they may reasonably be supposed to have been in the contemplation of both parties at the time they made the contract, as the probable result of the breach. While exclusion clauses will often refer to "indirect" or "consequential" loss, it is wise for parties to explicitly call out specific types of loss in respect of which they are looking to exclude liability (as evidenced by the decision in Transocean Drilling UK Ltd v Providence Resources Plc [2016] EWCA Civ 372 – a decision of persuasive authority in Ireland). For example, if a party is concerned regarding its exposure to loss of profit arising from a breach by its counterparty, this should obviously form part of commercial discussions and, if the principle is agreed, liability for loss of profit specifically should be provided for in the contract.

2. Limitation Clauses

Limitation clauses seek to cap the maximum claimable damages, typically by reference to the level and basis of professional indemnity insurance required to be held by the relevant party (in the context of consultants) or by reference to the contract value (in the context of contractors). Recent updates to public works contracts have introduced caps on liability within the forms of consultant agreements and building contracts. The inclusion of liability caps in public sector contracts may signal a broader trend towards the adoption of similar measures in the private sector. As the industry observes these developments, it will be interesting to see if private sector contracts follow suit, potentially leading to a more balanced and secure contracting environment across both public and private sectors.

In addition to these caps, limitations on liability can also apply by way of net contribution clauses. These are contractual provisions that alter the default position on joint and several liability under the Civil Liability Act 1961. The effect of joint and several liability is that where two or more wrongdoers contribute to damage, an injured party can pursue any one party for the full amount of the damage, regardless of their individual share of the fault. This means that a party who contributed only 10% to the damage could be pursued for 100% of the damages. A net contribution clause, if clearly drafted, seeks to limit each party's liability to their proportionate contribution to the damage.

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The structuring of liability caps often depends on the nature of the project and the relative bargaining power of the parties. Where a cap is being negotiated, of equal importance are the various heads of loss and damage which may be expressly carved out of the cap. Devoting the appropriate time to agreeing the carve outs can often result in developers and contractors reaching agreement more quickly on a balanced cap position which protects all respective legitimate interests. For example, a developer/employer will always be exposed to potential liabilities to third parties notwithstanding that such liabilities may arise from the act or default of the contractor. These may include: (i) liability for death, injury or property damage to third parties arising in connection with the work, and/or (ii) statutory fines or penalties. Given that the developer/employer will have little or no ability to control its exposure to such liabilities, it is difficult to see why the contractor's exposure for such liabilities vis-à-vis the developer/employer should be capped, particularly given that the third party could decide to pursue the contractor directly. In such circumstances, the contractor's liability vis-à-vis the third party would not be capped.

Additionally, parties should be clear when drafting carve-outs as they are typically worded such that the overall cap does not apply to the liability carved out, but this does not clarify if any such liability is still to accrue towards the overall cap. As such, clarity in the drafting is paramount.

3. Time Limitations

Under Irish law, where a contract has been executed as a simple contract, claims for breach of such contract have a six-year limitation period running from the date of breach. If the contract is executed under seal, the period extends to 12 years. However, parties have the flexibility to agree on custom limitation periods, which can override statutory limits. For example, in the case of Inframatrix Investments Ltd v Dean Construction Ltd [2011] EWHC 2155 (TCC), the court upheld a one-year limitation period from practical completion.

Conclusion

Limits on liability in construction contracts are useful for risk management, yet they must be carefully considered in the context of the complexities of the particular construction project and the potential liabilities that may arise. Courts emphasise precision and fairness in liability clauses, reinforcing the need for clear drafting. Case law in Ireland and England and Wales illustrates a trend toward greater judicial scrutiny, requiring parties to ensure that any agreed limitation and exclusion clauses are transparent and clearly drafted. Getting the limitation regime applicable to a particular project may require time but will ensure protection for the legitimate interests of all parties. ■

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