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## INTERNATIONAL JOURNAL OF ADVANCED RESEARCH (IJAR)

Article DOI:10.21474/IJAR01/10339

DOI URL: <http://dx.doi.org/10.21474/IJAR01/10339>



### RESEARCH ARTICLE

#### STUDY ON LIMITATION OF LIABILITY

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#### Manuscript Info

##### Manuscript History

Received: 27 November 2019

Final Accepted: 30 December 2019

Published: January 2020

#### Abstract

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#### Introduction:-

When two parties enter into a contract to perform a certain task, there are many risks and liabilities attached during the performance of contract. Few liabilities may arise out of the party's own mistake or which may occur due to external factors in which the party has no control on. It is almost impossible to fulfill each and every obligation as such. Few at times the party to contract will not be able to compensate the other in case of breach as the party is not in a right financial position to do so. So, in order to overcome all these problems limitation of liability clause is added by negotiating it with the other party to contract. After being agreed by the parties to contract, they sign the contract showing their acceptance.

#### Statement of Problem:

This paper is primarily aimed at analysing the need and nature of the limitation of liability clause present in the contract. It covers the areas in which the limitation of liability clause can be used and also the areas in which limitation of liability clause cannot be used. Key elements needed to draft limitation of liability clause have also been covered.

The purpose of this is to understand the effect and nature of limitation of liability clause.

#### Research Questions:

To ensure clarity of scope of this work, certain research questions have been framed by the researcher. This project primarily attempts to answer the following research questions:

1. What is limitation of liability?
2. What are the areas where limitation of liability can be established?
3. What are the areas where limitation of liability cannot be established?
4. What are the differences in limitation of liability between Indian law and English law?
5. What are the essentials to be considered while drafting a limitation of liability clause?

#### Research Methodology:-

The research undertaken is purely doctrinal research. The researcher had to refer websites and journals to collect the necessary information needed for the research paper.

#### Method of Citation:-

The citation design that has been uniformly followed in this paper is Harvard Bluebook, 19<sup>th</sup> edition.

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**Chapter 1:**  
**Limitation of liability**  
**Liability**

Liability means legal responsibility for one's acts or omissions. Failure of a person or entity to meet that responsibility leaves him/her/it open to a lawsuit for any resulting damages or a court order to perform (as in a breach of contract or violation of statute)<sup>1</sup>.

So, in order to reduce these liabilities in few of the circumstances the parties to the contract negotiate to reduce the liabilities in few areas for the smooth and comfortable functioning of the contract. This reduction of liability in the contract is called limitation of liability clause.

**Limitation of liability**

A limitation of liability clause, or a liability clause, is defined as a disclaimer in an agreement that limits the conditions under which the disclaiming party may be held liable for loss or damages, and which further defines the limits of damages which may be claimed in certain instances<sup>2</sup>. This clause specifies the type and defines the boundaries of damages one party is obligated to provide compensation for a given failure to perform according to negotiated terms. It reduces the exposure any company may face in the event of a lawsuit filed against defaulting party.

This clause is a written statement that is used in most of the industries, including small and big business transactions, this clause is basically provided under the terms and condition of the agreement which is agreed upon by the parties to contract.

In case of absence of this clause the defaulting party would be held unlimitedly liable for the loss or damage incurred by the opposite party.

Limitation of liability clause is generally negotiated by the contracting parties in order to limit or increase the liability in certain areas or situations depending on their terms and for smooth functioning of the contract.

If the limitation of liability clause exists within the contract which stipulates a certain sum of money which is to be paid when the contract is breached, such stipulated penalty can be enforced under Section 74 of the Indian Contract Act, 1872. However, the penalty being enforced in this situation would not exceed the penalty which has been stipulated within the clause of the contract<sup>3</sup>.

**Purpose of limitation of liability**

As discussed above limitation of liability clause is used to reduce the liability of the contracting parties in certain areas or situations where the contracting party is default, if this clause is absent then the liability of the defaulting party to contract will be unlimited.

When a small company enters into a contract with a big company to do a particular task which inculcates big responsibility on the small company, then the small company incorporates the limitation of liability clause in order to exclude or limit its liability from indirect, incidental, consequential damages etc., caused by the small company to the big company, as the small company would not be in a sound financial position to compensate the bigger company. This clause can even be inculcated in contracts between big companies as well.

This clause is basically an indication about to what liabilities have been agreed to be limited in the contract. When both the parties agree to the clause then it can be added to the terms and conditions of the contract, the parties to contract sign the contract showing their acceptance towards the clauses. This clause can be added by anyone who are contracting with each other and not just in contracts between a small and a big company.

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<sup>1</sup> Available at <https://dictionary.law.com/Default.aspx?selected=1151> (last accesses on 10/01/2020)

<sup>2</sup> Available at <https://www.websitepolicies.com/blog/limitation-of-liability-clause> (last accessed on 10/01/2020)

<sup>3</sup> Anubhav Pandey. "Limitation of Liability Clauses in contracts", (Nov 2, 2017), <https://blog.ipleaders.in/26liability-clauses/>

**This clause can be best explained by an illustration:**

Abc company gets into a contract with a security agency to guard the abc company and not let outsiders enter the company premises. One of the security guard of the security agency unknowingly lets an outsider inside the company premises by which the trade secret was stolen from the company which valued in lakhs of rupees.

As the security guard was ignorant about the status of the person the loss has to be fully compensated by the security agency.

But as the agency gets paid less for its service and isn't financially sound to pay the compensation, so to avoid paying compensation it tries to limit its liability for any mis happening by providing a limitation clause in the contract.

**Bharathi Knitting Co. V. DHL Worldwide Express Courier<sup>4</sup>:**

Plaintiff manufacturer had an agreement with a German buyer for summer season, 1990 and consigned certain goods with documents sent in a cover by DHL courier on may 25, 1990 containing (i) invoice no.32, (ii) packaging list, (iii) original export certificate and certificate of origin no.t/wg/001316 dated 24.5.90 and a original gsp form a no.e1. It appeared that the cover did not reach the destination. Consequently, though the duplicate copies were subsequently sent by the date of receipt of the consignment, the season was over. Resultantly, the consignee agreed to pay only dm 35,000/- instead of invoice value dm 56,469.63. As a result, the appellant filed a suit against DHL for failing to deliver the cover on time and recover the difference of the loss incurred by the plaintiff in dm 21,469.63 equivalent to Rs.4,29,392.60 which was ordered.

It was observed by the court that the plaintiff had signed the note with DHL which clearly stated that (i) DHL would be liable to damages only to the extent of Rs.3,515/-, (ii) consequential damages will not be accepted and (iii) there was special notice that DHL is not liable for any loss or damages unless there is an insurance coverage to protect their interest.

By signing the note the plaintiff had shown his acceptance to the note. Hence, the court held that DHL is obligated to pay only Rs.3,515/- as damages to plaintiff as plaintiff had accepted to the limitation of liability clause in the note.

**Chapter 2:****Areas where limitation of liability can be established**

Following are the few important liabilities which can be limited by the parties to contract. Other liabilities which don't fall under the following liabilities can also be limited by negotiating the limitation clause, it is left to the discretion of the parties to contract.

1. Limitation of liability in terms of money
2. Limitation of liability in terms of consequential damages
3. Limitation of liability in terms of exemplary damages
4. Limitation of liability in terms of incidental damages
5. Limitation of liability in terms of remote damages

**Limitation of liability in terms of money:**

If the limitation of liability clause exists within the contract which stipulates a certain sum of money which is to be paid when the contract is breached, such stipulated penalty can be enforced under Section 74 of the Indian Contract Act, 1872. However, the penalty being enforced in this situation would not exceed the penalty which has been stipulated within the clause of the contract.

For example, if the limitation of liability clause of the contract stipulates that the maximum compensation provided will be Rs.10,000/-, then the penalty cannot exceed Rs.10,000/-.

An important thing while drafting such a limitation of liability clause is that the penalty has to be determined keeping into mind a fair estimation of damages which would cost from the breach. The money stipulated should not reach high levels such that the penalty would exceed the damage caused. For example, one cannot claim a penalty of Rs.10,000/- on a damage caused of only Rs.500/-.

<sup>4</sup> Bharathi Knitting Co. v. DHL Worldwide Express Courier, (1996) SCC (4) 704, JT 1996 (6) 254

This brings us to the second important principle of drafting such a clause, that it should mention a maximum amount, but state that the penalty shall not exceed that particular amount. This is to ensure that the balance between the breach actually caused and the penalty to be levied is actually maintained, and the courts on their discretion can determine the value of the penalty to be levied to the breach actually caused. If the clause includes “not exceeding Rs.10,000/-”, it allows any amount less than Rs.1,000/- to be levied as well depending upon the circumstances of the breach. But if the clause is worded as “Rs.10,000/- shall be paid for breach” it would result in Rs.10,000/- being levied for even the smallest of breaches, thus causing a disproportionate penalty to be levied.

Thus, the two important requisites which always have to be considered include a reasonable amount actually being stipulated as the penalty and an upper threshold being attached to such an amount.

Additionally, limitation clauses may be specific for breaches for specific nature. For instance, a dry cleaner can specify a certain sum of money for unclean laundry and a higher sum of money for excessive bleaching etc<sup>5</sup>.

**Following is an illustration for limitation of liability clause in terms of money:**

“In order for the member to benefit from the membership fee, the member agrees to limit the organization’s liability arising from the organization’s professional obligations, errors or omissions, such that the total liability of the organization shall not exceed the organization’s total fees for the membership and services rendered for the duration of the agreement.”

**Limitation of liability in terms of consequential damages:**

Consequential damages are also called special damages. This is a type of damage which doesn’t occur by the direct result of the incident but are instead consequence of that incident. Consequential damages are indirect in nature. The consequential damage done must be foreseeable in order to provide compensation to the person who has suffered. The defaulter must not only pay compensation to direct damage but should also pay compensation for consequential damages suffered by the aggrieved party.

**This can well understood by an example:**

Xyz company offers website development services. Abc company contracts with the xyz company to develop the website for his small business. Nothing known to abc company or xyz company, one of the programmers of xyz company builds a website for abc company and installs some virus in it. The code doesn’t harm abc company’s site, but infects its customers. Without a limitation of liability clause, xyz could be held liable for the amount and the harm caused to abc company. With a limitation of liability, xyz company could limit the total liability to the amount paid in the contract and it could also prohibit special or consequential damages.

Companies in order to avoid or limit the liability arising out of consequential damage they include the limitation of liability clause in their terms and condition section in order to separate themselves from being fully liable to pay compensation for the consequential damage that has been occurred due to breach of the contract.

Failure of adding such a clause may result the defaulting company to pay for the direct damages as well as consequential damages occurring out of the default committed towards the other contracting party.

Consequential damages include everything from loss of profits due to interruption of normal business practise, to loss of customers due to delays or cancellations.

**Following is an illustration for limitation of liability clause in terms of consequential damage:**

“Not with standing anything written here in to the contrary, the buyer and the company acknowledge and agree that the company will not be liable for any losses or damages, whether indirect, incidental, exemplary, special or consequential, in profits, goods or services, irrespective of whether or not the buyer has been advised or otherwise might have anticipated the possibility of such loss or damage.”

<sup>5</sup> Anubhav Pandey. ”Limitation of Liability Clauses in contracts”, (Nov 2, 2017), <https://blog.ipleaders.in/26liability-clauses/>

**Limitation of liability in terms of punitive/exemplary damages:**

Punitive damages are also called exemplary damages. Punitive damages are the damages which are awarded to the plaintiff, in addition to compensatory damages, in order to punish the defaulter for a reckless act and so that the defaulter doesn't repeat it in the future.

**This can be well understood by an example:**

Two people died in a car accident, which their families claim was the fault of abc car manufacturer, the maker of the car the two people were driving. The families filed a civil lawsuit against abc car manufacturer, and submitted evidence that the steering knuckle broke, causing the fatal crash. In addition, abc car manufacturer had more than a decade in which notices were received about defects in that model vehicle's steering knuckles, but chose not to act.

At the conclusion of the court ordered the company to pay Rs.1,00,000/- as compensatory damages and Rs.3,00,000/- as punitive damages in order to make sure that the abc car manufacturer doesn't repeat the same mistake again.

Companies in order to avoid or limit the liability arising out of punitive damage they include the limitation of liability clause in their terms and condition section, by clearly mentioning about limiting the liability in case of punitive damages, in order to isolate themselves from being fully liable to pay compensation for the punitive damage that has been occurred due to breach of the contract.

Failure of adding such a clause may result the defaulting company to pay not only the compensatory damages but will be even liable to pay for the punitive damages occurring out of the default committed towards the other party.

**Following is an illustration for limitation of liability clause in terms of exemplary damage:**

"Notwithstanding anything written herein to the contrary, the buyer and the company acknowledge and agree that the company will not be liable for any losses or damages, whether indirect, incidental, exemplary, special or consequential, in profits, goods or services, irrespective of whether or not the buyer has been advised or otherwise might have anticipated the possibility of such loss or damage."

**Limitation of liability in terms of incidental damages:**

Incidental damages are the damages incurred by a party to the contract as a result of other party's breach of contract. These are the damages that were not expected during making of contract, but which arise because of breach of contract. These damages may be awarded in addition to the compensatory damages. Incidental damages are the direct consequences faced by the plaintiff due to breach of contract.

**This can be well explained by an example:**

Xyz watch company contracts to sell 100 smart watches to abc store by mid-december and do so the xyz watch company enters into a purchase agreement with the supplier to buy the necessary chips required to manufacture smart watches. But the supplier fails to supply the chips, breaching the contract. Abc store unable to change their timeline, gives the contract to other watch manufacturing company due to failure of the xyz watch company. Thus, xyz watch company loses the contract and has to refund the abc store's money. The losses incurred by xyz watch company are directly influenced by the supplier's breach contract and is liable to pay direct damages as well as incidental damages. Here direct damage is the amount spent on getting into an agreement with the supplier and incidental damage is the loss incurred by the xyz watch company by losing the contract with abc store.

In order to limit the liability to pay compensation for incidental damage, the supplier can inculcate the limitation of liability clause in his agreement with xyz watch company, which clearly mentions about limiting the liability in case of incidental damages.

Companies in order to avoid or limit the liability arising out of incidental damage they include the limitation of liability clause in their terms and condition section in order to isolate themselves from being fully liable to pay compensation for the incidental damage that has been occurred due to breach of the contract.

Failure of adding such a clause may result the defaulting company to pay not only the direct damages but will be even liable to pay for the incidental damages occurring out of the default committed towards the other party.

**Following is an illustration for limitation of liability clause in terms of incidental damage:**

“Notwithstanding anything written herein to the contrary, the buyer and the company acknowledge and agree that the company will not be liable for any losses or damages, whether indirect, incidental, exemplary, special or consequential, in profits, goods or services, irrespective of whether or not the buyer has been advised or otherwise might have anticipated the possibility of such loss or damage.”

**Limitation of liability in terms of remote damages:**

Companies can limit their liability in the areas of remoteness of damage by clearly mentioning a limitation of liability clause stating that the party to contract shall not be liable for any remote damages that have occurred due to the breach of contract or non-fulfilment of contract.

The defaulting party is only liable for reasonably foreseeable losses that a normal reasonable person can foresee and is not liable for very much remote losses which have been suffered by the plaintiff.

**This can be well understood by an example:**

Abc company gets into a contract with xyz bank to deliver an e-banking software. After abc company delivers the e-banking software to the xyz bank, one of the bank's customer faces e-banking software crash due to which he couldn't transfer money from his account to his friend's account, which resulted in the friend's son's death as the friend failed to pay for medication of his sick son as he didn't get the money in time from the customer of the bank.

The abc company can be held liable for the crash in the software but can't be held liable for the loss incurred by the customer's friend as it is very remote and no reasonable man can be able to foresee it.

So, in order to limit the company's liability in the contract, limitation of liability clause is mentioned in the terms and conditions areas of the contract stating that the company shall avoid the liability occurring out of the remote damage caused.

**Chapter 3:****Areas where limitation of liability cannot be established:**

Following are the liabilities which cannot be limited or escaped by mere inclusion of the limitation clause. Even if the following areas have been limited under the limitation clause it would not be valid in the eye of law. The liability arising out of these following areas is full liability.

1. Death or injury of a person
2. Fraud or bad faith
3. Fraudulent misrepresentation
4. Amount too low
5. Criminal offences
6. Gross negligence

**Death or injury of a person:**

In an instance where a person has lost his life or has been injured due to the breach of contract or default by a party, then the defaulting party is liable to pay compensation or damages to the aggrieved party even if there is a limitation of liability clause which has been inculcated in the contract to limit or avoid a certain liability.

For example, abc company sells a faulty laptop to xyz company. One of the employees of xyz company while using the laptop experiences sudden burns on his hands due to faulty electric discharge from the laptop.

Abc company cannot take any defence under the limitation of liability clause present in the contract and is fully liable to pay compensation.

**Fraud or bad faith:**

When a party to contract does an act or omission with bad faith or with an intent to defraud the other party, then party doing such an act or omission is fully liable to pay compensation for the loss incurred by the suffered party. Defaulting party cannot take any defence under the limitation of liability clause which has been inculcated in the contract to avoid liability.

For example, abc company hires xyz security agency to guard the abc company building and not let outsiders into the building. One of the security guard of the xyz security agency allows an outsider into the abc company building with bad faith. Abc company suffers huge loss as confidential files have been stolen.

Xyz security agency cannot take defence under the limitation of liability clause present in the contract as there was bad faith and an intention to defraud and hence is fully liable to pay compensation.

#### **Fraudulent misrepresentation:**

When a party to contract conveys an untrue information to the other party in order to fraudulently induce the party to contract, then the party doing such wrongful representation will be made fully liable to pay compensation for the loss incurred by the other party due to the fraudulent misrepresentation done. Such defaulting party cannot take defence under the limitation of liability clause which has been inculcated in the contract by the parties to contract.

For example, abc sells a car to xyz, misrepresenting that it was in the best condition in order to defraud xyz. Trusting abc, xyz buys the car. Later on, xyz finds that the engine of the car is not in a proper working condition.

Abc cannot take any defence under the limitation of liability clause present in the contract as there was a fraudulent misrepresentation done by abc and hence he will be fully liable to pay compensation to xyz.

#### **Amount too low:**

Reasonable and clearly drafted limitation of liability clause in the contract agreed by the contracting parties and which has been reasonably negotiated, will be generally upheld by the court. However, courts generally do not agree to limitation of liability clause where the amount entered is too low that eliminates the company's liability.

#### **This can be well understood by an example:**

Abc contracted with an xyz engineering firm to conduct a "limited visual review" of a house he intended to purchase. The contract, a single-page, four-paragraph document that specified a fee of Rs.800/-, contained a one-sentence limitation of liability clause in the third paragraph, which read: "the liability of xyz engineering firm and the liability of its employees are limited to the contract sum."

The plaintiff signed the contract and the services were performed. The defendant delivered a two-page written report, and the plaintiff purchased the house.

Soon afterward, problems with the house were discovered including a broken water pipe and weak ceiling. The plaintiff hired another engineer, had repairs made to the house and sued the defendant for rs.3,00,000/- for failure to detect the problems.

Court then invalidated the limitation of liability clause, ruling it was too vague and the specified amount (rs.800/-) was too low in comparison to the actual damages (Rs.3,00,000/-)

#### **Criminal offences:**

When a party to contract does any criminal offence in due course of the contract due to which the other party to contract had to face losses then the defaulting party is supposed to fully compensate the suffered party and the defaulting party cannot take defence under the limitation of liability clause present in the contract.

For example, abc company hires xyz security agency to guard the abc company building. One of the security guard of the xyz security agency plants a bomb in the abc company building with bad faith. Abc company suffers huge life and property loss.

Xyz security agency cannot take defence under the limitation of liability clause present in the contract as there was a criminal offence committed and hence is fully liable to pay compensation.

#### **Gross negligence:**

Gross negligence is a conscious and voluntary disregard of the need to use reasonable care, which is likely to cause foreseeable grave injury or harm to persons, property, or both. It is conduct that is extreme when compared with ordinary negligence<sup>6</sup>.

<sup>6</sup> Available at <https://legal-dictionary.thefreedictionary.com/gross+negligence> (last accessed on 10/01/2020)

When a party to contract shows gross negligence to the other party, then party doing such an act or omission is fully liable to pay compensation for the loss incurred by the suffered party. Defaulting party cannot take any defence under the limitation of liability clause which has been inculcated in the contract to avoid liability.

For example, abc company hires xyz gardening agency to take care of plants in the abc company building. One of the gardeners of the xyz gardening agency doesn't water plants for a month in the abc company building showing gross negligence. Abc company suffers loss of plants.

Xyz gardening agency cannot take defence under the limitation of liability clause present in the contract as there was an act of gross negligence committed and hence is fully liable to pay compensation.

#### **Illustrations of limitation of liability clause:**

##### **Illustration 1:**

Except for breaches of confidentiality, neither party will be liable to the other party for any special, indirect, consequential or incidental damages of any kind, including, without limitation, any loss of profit, loss of use, or business interruption, based on any claim under this agreement, even if such party has been advised of the possibility of such damages.

To the extent permitted by applicable law, in no event shall the liability for damages hereunder of provider or any member of the provider group or its employees or agents exceed the amounts actually paid to provider by customer.

From the above illustration it can be observed that the company which is incorporating the limitation of liability clause in its contract is stating that the company shall not be liable to any kind of special, indirect, consequential or incidental damages of any kind including loss of profit, loss of use, or business interruptions arising out of breach of contract even if the company has been advised of the possibility of such damages. It also states that to extent the law permits the company or member of the company or employee or agent shall not be liable for any damages which exceeds the amount actually paid to company by customer.

It can also be derived from the limitation clause that the company is not limiting its liability from breach of confidentiality, direct damages, punitive damages, loss of goodwill, fraud, fraudulent misrepresentation, negligence, criminal offences and in case of death or injury.

The parties to contract negotiate with each in order to increase or decrease the limitation of liability in the contract. Once both the parties negotiate and are satisfied by the clause then the negotiated clause is inculcated into the contract. The contract later is signed by the parties to contract to show their acceptance.

When two parties enter into a contract to perform a certain task, there are many risks and liabilities attached during the performance of contract. Few liabilities may arise out of the party's own mistake or which may occur due to external factors in which the party has no control on. It is almost impossible to fulfill each and every obligation as such. Few at times the party to contract will not be able to compensate the other in case of breach as the party is not in a right financial position to do so. So, in order to overcome all these problems limitation of liability clause is added by negotiating it with the other party to contract. After being agreed by the parties to contract, they sign the contract showing their acceptance.

##### **Illustration 2:**

Except for third party claims covered under the indemnification provisions of this agreement, to the fullest extent permitted by law, neither customer nor provider shall be liable to the other or any other person for any injury to or loss of goodwill, reputation, business, production, revenues, profits, anticipated profits, contracts or opportunities (regardless of how these are classified as damages), or for any consequential, incidental, indirect, exemplary, special, punitive or enhanced damages whether arising out of breach of contract, tort (including negligence), strict liability, product liability or otherwise (including the entry into, performance or breach of this agreement), regardless of whether such loss or damage was foreseeable or the party suffering the loss or damage has been advised of the possibility of such loss or damage, and notwithstanding the failure of any agreed or other remedy of its essential purpose.

From the above illustration it can be observed that the provider which is incorporating the limitation of liability clause in its contract is stating that to the fullest extent permitted by law, neither provider nor customer be liable for



any kind of injury, loss of goodwill or reputation, loss of profits and revenues, punitive damages, torts, special, indirect, consequential or incidental damages of any kind including loss of profit, loss of use, or business interruptions arising out of the breach contract even if the company has been advised of the possibility of such damages of even if foreseeable.

It can also be derived from the limitation clause that the provider or customer is not limiting its liability from third party claims under indemnification provision of the agreement, breach of confidentiality, direct damages, punitive damage, fraud, fraudulent misrepresentation, negligence, criminal offences and in case of death.

The parties to contract negotiate with each in order to increase or decrease the limitation of liability in the contract. Once both the parties negotiate and are satisfied by the clause then the negotiated clause is inculcated into the contract. The contract later is signed by the parties to contract to show their acceptance.

#### **Chapter 4:**

##### **Difference in limitation of liability between indian law and english law**

A limitation of liability clause is basically valid and enforceable under indian law, except in the areas where limitations on liability arising by reason of death or personal injury, fraud or gross negligence are not enforceable. Moreover, the limitation of liability clause should be reasonable and enforceable. Regarding this context it is similar to english law.

The ability of a party to claim damages for breach of contract is limited to the actual damages or losses suffered by that party arising from the breach. Section 73 of the indian contract act (ica) provides that, in order to recover for breach of contract, the aggrieved party must show that such damage naturally arose in the usual course of things from the breach, or was damage which the parties knew would be likely to result when they made the contract.

However, section 73 also provides that compensation for loss or damage caused by breach of contract is not to be given for any remote and indirect loss or damage sustained by reason of the breach.

This is different from english law where, although we have the same two types of loss that can be recovered (the two limbs in the case of hadley v baxendale) we do not have any statutory prohibition on the ability of a party to recover for indirect loss. English law simply relies on the application of the rules of remoteness.

Under english law we are used to describing the second limb of hadley v baxendale loss which does not arise naturally from the breach but which must still have been within the reasonable contemplation of the parties when the contract was made as 'indirect loss', but under indian law it is better not to use that expression in order to avoid classifying the loss as an irrecoverable loss under section 73, unless that is positively what is intended.

It is worthwhile also reminding ourselves that, under english law, per the british sugar case, "consequential loss" does not mean loss flowing naturally as a consequence of a breach, which might seem the obvious meaning, but loss 'over and above that which arises as a direct result of the breach' (in other words a form of indirect loss), and indian law views consequential loss in the same way<sup>7</sup>.

#### **Chapter 5:**

##### **Drafting of limitation of liability clause**

The limitation of liability clause drafted in a contract should not be one sided as it does not do the right justice to the other contracting party. The clauses which are incorporated in the contract must be reasonable and enforceable by law otherwise the court will not favour the limitation of liability clause.

There should be a frank discussion between the parties to contract in order to develop a sound limitation of liability clause. During the discussion the parties to contract have to negotiate the terms relating to what areas the liabilities to be increased and in what areas liabilities is to be decreased. The clauses which are added must be understood by parties to contract in the right sense. Once negotiated the clause is added to the contract.

<sup>7</sup>Jonathan Riley. "Contracting Under Indian Or English Law: Part 2- Key Contract Difference", (Sept 1, 2008) <http://www.mondaq.com/india/x/65440/Contract+Law/Contracting+Under+Indian+Or+English+Law+Part+2+Key+Contract+Differences>

There are a few times when one of the contracting parties do not agree to negotiate on a certain area, then the best possible way to make the situation better is by using 'reciprocity' approach. The idea is that the most that they can ever recover from you is equal to the most you can recover from them<sup>8</sup>. For example, if abc makes a clause stating that xyz should pay Rs.500/- in case of incidental damage and doesn't agree to negotiate it, then by using 'reciprocity' even xyz can ask abc to add the same clause to himself where xyz can recover Rs.500/- from abc in case of incidental damage. By this both the parties to contract are on a same status and it prevents from the clause to be one sided. This is done when the negotiation is not accepted.

Another type of approach is where the party to contract tells the other party to exclude certain type of liability from being limited for smooth and comfortable functioning of the contract.

There are few types of liabilities which cannot be limited like in case of death or injury, fraud, fraudulent misrepresentation etc. Even if these liabilities are limited in the contract the court will not agree to it and make the defaulting party to be liable and pay compensation for the same.

It should be made sure by the contracting parties that the clauses are well understood before signing the contract, because once signed, the party cannot sue the other for full liability for an act which is limited. Even the court cannot object to it as it is agreed and signed by the parties to contract.

In order for the limitation of liability clause to be valid in court, the clause is generally typed in capital and bold letters just before the area where the party to contract signs in order to show that the contracting party has read and understood the limitation of liability clause and has signed it.

### **Conclusion:-**

Limitation of liability clause is an essential clause which has to be added when it comes to the drafting of the contract as it lays down clear boundaries on the liabilities of the parties of contract due to which the performance of the contract happens smoothly and comfortably without the worry of the liabilities attached with it. 100% obligations arising out of the contracts cannot be fulfilled in the real world, so it becomes very difficult to contract as small errors or damage caused by external factors have to be compensated in absence of limitation of liability clause. Limitation of liability clause tries to reduce or limit the liabilities of the party to a certain extent negotiated by the parties to the contract which gives the contracting party to give his best in performance of the contract without any fear of the liabilities and also helps the party who may not be sound financially to bear the liabilities. But the parties to contract must make sure that the terms decided in the limitation of liability are reasonable so that the agreement is not one sided. It is often seen that the person drafting the limitation of liability clause tends to make it one sided which is not fair, hence it should be made sure that the other party suggestions are also taken into consideration while drafting the limitation of liability clause. It shall be considered to be a fair and a proper limitation of liability clause when both the parties to contract are satisfied and benefited out of the clause negotiated.

But it is also suggested that the contracting parties to contract do not limit a lot of its liabilities under limitation of liability clause as it would defeat the very purpose of coming into a contract, it should be seen that only indirect liabilities arising out of the contract must be limited and the limitation of liability clause added to contract must be reasonable and properly negotiated by the parties to contract.

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<sup>8</sup>Available at <https://www.ecomputerlaw.com/negotiating-a-vendors-limitation-of-liability-clause> (last accessed on 10/01/2020)