Limitations of Liability and Indemnities

• Overview
  • Rationale
  • Key elements of an effective clause
  • Alternatives to the standard clause
  • Drafting issues
Limitations of Liability

• Rationale for limitation of liability clauses
  • Certainty of remedy in the event of breach
  • Use of bargaining power to limit adverse consequences in the event of breach
Limitations of Liability

• Rationale for limitations clauses
  • Common law approach to liability and damages does not provide certainty
    • Plaintiff can elect damages measure: reliance or expectation
    • Extent of damages limited by remoteness and foreseeability: subjective/objective factual inquiry
      • Uncertain
      • Small breach can lead to LARGE damages
Limitations of Liability

• Rationale for limitations clauses
  • Common law approach to liability and damages does not provide certainty
    • Alternative causes of action that can supplement breach of contract claim
      • Tort: negligence
      • Other duties: good faith, fiduciary duty
    • Alternative causes of action have different potential damages measures
Limitations of Liability

- Key Elements of a Limitation of Liability Clause:
  - Party receiving the benefit of the limitation
  - Party agreeing to be limited
  - Liabilities to which the limitation applies
    - Causes of action
  - Categories of damages which are excluded/limited
  - Amount of any limitation
Limitations of Liability

• Liabilities to which the limitation applies
  • Not just breach of contract
  • Not just negligence but any tort, and any breach of duty (good faith, fiduciary)
  • Not just matters addressed by contract but any conduct in the course of performance of contract (i.e., negligence, gross negligence, or willful misconduct)
Limitations of Liability

• Categories of damages which are excluded/limited:
  • Traditional formulation: excludes “indirect or consequential damages” as opposed to “direct”
    • MEANINGLESS in Canada
  • Example: what are lost profits?
Limitations of Liability

• Categories of damages which are excluded/limited:

• Better practice:
  • Identify specific types of damages to be excluded: i.e., “lost revenues or profits, loss of business value or loss of business opportunity”
  • Avoid linkage to traditional language or what Ken Adams refers to as “jargon”
Limitations of Liability

• Amount of any limitation
  • Options:
    • Based on value of contract
    • Fixed amount as a maximum
    • Fixed amount as specified:
      • Beware of liquidated damages rules
• Clause negotiated in favour of vendor in a APA

• **Limitation of Liability**: The Parties agree that any claims for breach of the written terms of this Agreement shall be subject to the following limitations and exclusions:
  a) All claims for interlocutory and permanent injunctions, or for specific performance, are excluded entirely;
  b) All claims for rescission are excluded entirely;
  c) All claims for punitive, exemplary and aggravated damages are excluded entirely;
Limitation of Liability: An Alternative Approach

d) Any other claim for damages shall be limited to the recovery of out-of-pocket costs directly arising from a breach. For further clarity, the following claims for damages are excluded entirely:

i) Loss of profits or revenues;
ii) Loss of business value;
iii) Loss of business opportunity; and
iv) Indirect or consequential damages.
e) The foregoing provisions shall not be taken to exclude the operation of otherwise applicable legal requirements respecting causation, foreseeability, remoteness and mitigation of damages to the assessment of damages which are not otherwise excluded or limited by this section.

f) Notwithstanding the foregoing, the maximum aggregate amount recoverable in respect of any and all claims for damages for any breach of the written terms of this Agreement shall be  •.
Limitation of Liability: An Alternative Approach

• The clause is presented in a “menu” format
• Permits the negotiator and drafter to focus on the liabilities, remedies, and damages that are to be limited or excluded
• Expressly sets a fixed amount as the cap on any damage claim
Indemnities: Rationale and Purpose

• Definition of Indemnity
  1. To reimburse (another) for a loss suffered because of a third party’s or one’s own act or default.
  2. To promise to reimburse (another) for such a loss.
  3. To give (another) security against such a loss.

Black’s Law Dictionary
i) Third party indemnities

• Agreements or relationship may place a party in a situation where a third party can advance a claim against them

• The purchaser in an asset purchase agreement may assume certain liabilities when hiring employees of the seller

• The purchaser’s possible liability is not to the direct contracting party (the vendor) but to a third party (an employee of the vendor)
ii) Indemnity for Direct Claims

- A party seeks indemnity from the other party to an agreement or relationship for defined liabilities and losses.
- An indemnity for direct claims permits the parties to negotiate and agree as to the definition of and process for determining direct claims between the parties.
Indemnities – Key Elements of an Indemnity Clause

1. Definition of parties giving and receiving the indemnity

2. Type of claim
   - Limited to third party claims
   - What direct claims are covered
3) Categories of Damages

- Breach of reps, warranties, covenants
- Environmental/Tax
- Assumed/Excluded Liabilities
- Third Party Claims
4) Scope of Damages/Remedies

• Direct vs. Indirect
• Consequential, Incidental or Punitive Damages
• Loss of Profits/Business/Diminution in Value
• Rescission
• Injunctions/Specific Performance
5) Liability Limitations

• Survival Period of Reps/Warranties (Covenants?)
• Thresholds/Deductibles
• Caps (Purchase Price/Fees)
• Exclusions (Fraud, Title, Authority)
6) Procedure

• Notice of Claim
• Direct vs. Third Party Claims (Control of Litigation)
• Arbitration
7) Other issues

- Mitigation
- Insurance/Tax Benefits
- Third Party Beneficiaries
8) Exclusive Remedy

• vs. Non-Exclusive

• Carve-outs – fraud, specific performance/injunctions, specific dispute resolution provisions (e.g., price adjustments)
• What an Indemnity Adds
  • Damages without Breach of Contract
  • Limits/Expands Scope/Type of Damages/Remedies for Breach
  • Limits/Expands Liability for Monetary Damages
  • Clarifies Procedure
Limitations of Liability and Indemnities

• Drafting Issues
  • Develop checklist of issues to cover issues to be addressed
  • Avoid language or jargon that is not clearly defined
    • Consequential loss
    • Indemnify and “save harmless”
• Ensure that defined terms include all the anticipated costs that are to be included/excluded

• Example – “loss” means any and all loss liability, damage, cost, expense, charge, fine, penalty or assessment, resulting from or arising out of any Claim, including the costs and expenses of any Legal Proceeding, assessment, judgment, settlement or compromise relating thereto and all interest, fines and penalties and reasonable legal fees and expenses incurred in connection therewith