Getting away with intentional breach

STUART JORDAN* examines the enforceability of contractual clauses that exclude liability for intentional breach, highlighting a recent case where such a clause was upheld even for a party's own fraudulent acts.

CAN a party exclude liability for its own fraudulent breach of contract? It would seem to be a futile discussion because surely such a provision would be unenforceable, under any governing law? Well, maybe not.

Breach, of course, is normal in construction projects, so it is no surprise that construction contracts recognise breach and make various allowances for it in terms of liability caps and exclusions of certain types of liability such as indirect and consequential losses.

We have looked at the question of intentional breach before; specifically the extent to which a contract can effectively limit or exclude liability for intentional breach, given the obvious public policy objections to such an arrangement. We concluded that it depends on the governing law and legal principles applying to performance of the contract. English law again shows itself to be the most permissive in its willingness to uphold such provisions – but not to the extent that a party's compliance with the contract becomes essentially a voluntary act. In contrast to that approach, intentional breach contravenes core legal principles in the Gulf region.

Today's topic takes us a step further: into situations involving actual dishonesty. There are two important distinctions in looking at the contractual consequences of fraudulent behaviour:

First is the question of whether the fraud induced a party to enter into the contract; or whether the fraud was limited to the performance of an existing valid contract.

Second is the question of whether the fraud was committed by the party itself or by agents or employees of that party, unknown to the senior people in control of the party.

A recent case came to the Technology and Construction Court in England, looking at these questions. Here, a pharmaceutical developer (Innovate Pharmaceuticals Ltd) entered into a research and testing agreement with the University of Portsmouth Higher Education Corporation related to a liquid aspirin developed by Innovate.

Jordan ... intentional breach contravenes core legal principles.

The university's lead researcher published an academic paper on this work, which Innovate alleged was deliberately and dishonestly infected with errors and manipulations of the research data. Innovate said that the testing was useless and would have to be repeated – and it claimed in excess of $125 million in damages for the cost of those new tests and for lost profits due to damage to the value of their patent.

The research contract, however, included the following provisions on liability:

"11.4 Except as provided in clause 11.5 the University is not liable to [Innovate] because of any representation (unless fraudulent), or any warranty…condition or other term, or any duty at common law, non-observance or non-performance of this Agreement, for…loss of profits, business, contracts, opportunity… expenses, costs or other similar loss…and/or any indirect, special or consequential damages or losses (whether for loss of profits or otherwise)." and

"11.5 The liability of a Party to another howsoever arising (including negligence) in respect of or attributable to any breach, non-observance or non-performance of this Agreement or any error or omission (except in the case of death or personal injury or fraudulent misrepresentation) shall be limited to £1 million."

Among several issues, Innovate argued that these provisions cannot be effective in excluding or limiting liability for acts of (in their submission) a fraudulent nature. It is also worth noting that cl.11.5 does not expressly include fraudulent acts within the £1 million liability cap; it merely carves out "fraudulent misrepresentation" from that cap. So the argument for limiting liability for fraudulent acts rests on a general description of liability "howsoever arising".

The court, however, upheld these provisions as effective exclusions and limitations, in these circumstances. This, they said, is a matter of construction of the contract and not a matter of legal principle. Exclusion clauses are intended by the parties agreeing them, to be effective; and because limitation clauses (like cl.11.5) do not attempt to exclude all liability, they are not treated with the same hostility as full exclusion clauses.

Crucially, the general reference to liability "howsoever arising" was held to be capable of covering these alleged breaches. Many observers would have expected, at the very least, that fraudulent acts would need to be expressly mentioned.

In relation to the two key distinctions mentioned above: this dispute was about contract performance, and the court noted that it remains impossible to exclude liability for fraudulent acts in inducing the other party to enter into a contract – as would in any event have been excluded from the cap in cl.11.5 as "fraudulent misrepresentation".

The bigger news is that the court noted that a provision excluding a party's liability for its own fraudulent acts can be upheld, even if this outcome is less likely than if it only seeks to exclude or limit liability from acts of employees or agents.

We should take note of this decision. Negotiating parties tend not to worry too much about this point, assuming that fraud is always something for which a party will be held liable. Generally-worded exclusion and limitation provisions might be more effective than is assumed. ■

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