



## 103:Limitation of Liability in International Sales & Service Contracts

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## Faculty Biographies

### Deborah J. Carlson

Deborah J. Carlson holds the position of senior counsel with MicroStrategy Incorporated, responsible for the international operations. MicroStrategy Incorporated, in McLean, Virginia is a public company and a leading worldwide provider of business intelligence software, listed on the NASDAQ. Her responsibilities include providing legal advice with regard to international contract matters (with focus on software licensing, including export matters) as well as international corporate matters.

Prior to joining MicroStrategy Incorporated, she was working at Baer and Karrer, attorneys at law, a major Swiss law firm, providing legal counsel on tax matters and large M&A transactions in Zurich, Switzerland.

She is a member of the ABA and the Swiss Bar Association.

Ms. Carlson holds an LL.M. from Duke University and a JD from the University of Zurich. She speaks and works in French, German, Italian and English.

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### Michael F. Pillow

Michael F. Pillow is assistant general counsel with Siemens Westinghouse Power Corporation in Orlando, which sells and services turbine generators and other power generation equipment. His principal responsibility involves legal matters for the Siemens global service organization, including strategic and commercial transactions and legal compliance.

Mr. Pillow has held a variety of positions with Siemens Westinghouse and Westinghouse Electric Corporation. He has handled commercial contracts, forming and implementing subsidiaries, joint ventures and alliances, domestic and international acquisitions and divestitures, corporate governance and compliance, dispute resolution, and labor and employment matters. Prior to joining Westinghouse, he worked for two law firms in Pittsburgh.

Mr. Pillow is an Authorized House Counsel in Florida. He is a member of ACCA and is currently president of ACCA's Central Florida Chapter.

Mr. Pillow received his BA from the University of Virginia and his JD from the University of Pittsburgh School of Law.

**Thomas M. Yih**

Thomas M. Yih is corporate counsel—international for Storage Technology Corporation in Denver. His responsibilities include providing legal counsel to StorageTek's international divisions on transactional matters, corporate governance, employment, and U.S. export compliance.

Prior to joining StorageTek, Mr. Yih was associate counsel with Maytag Corporation in Newton, Iowa. While at Maytag, he led the international trade practices group.

Mr. Yih has had two articles published in the *ACCA Docket*. "Six Steps to Better Foreign Counsel Relationships" and "Creating an International Distribution Database and Termination System."

He received a BA from Wittenberg University in Springfield, Ohio and is a graduate of Suffolk University Law School in Boston. Mr. Yih is pursuing his MBA in international management at The American Graduate School of International Management ("Thunderbird").

## LIMITATIONS OF LIABILITY IN INTERNATIONAL SALES AND SERVICE CONTRACTS

### INTRODUCTION

- **Approaches to Contractual Limitations of Liability**
- **Application of LOLs in Particular Circumstances**
  - **Common Law**
  - **Civil Law**
  - **Contracts with Government Entities**
- **Themes**
  - **Global approach increasingly similar**
  - **Common means for allocating risks between commercial entities**
  - **LOLs not enforceable under certain circumstances**
  - **Use/enforceability requires consideration of local laws and practices**
  - **Contract language requires careful drafting**
  - **Ensure company management review/approval**
- **Consideration of Sample Language**

### I. Principal Types Of Limitations

- **Limits On Amount Of Liability (Caps)**
  - **Absolute Monetary Limitations**
  - **Percentage of Contract Price**
  - **Aggregate/Total v. Periodic**
  - **Specific Caps for Particular Types of Incidents or Damages**
- **Disclaimers/Exclusions Of Certain Types Of Damages**
  - **Consequential Damages**
  - **Indirect Damages**
  - **Special or Punitive Damages**
  - **Specific Damages such as Lost Profits, Claims of Customers**
- **Liquidated Damages**
  - **Agreed Estimation of Damages in Lieu of Actual Damages**
  - **Limit to Amount or Percentage of Contract Price**
  - **Distinguish from Penalties (Common Law)**
  - **Exclusive Remedy**
- **Exclusivity of Remedies**
  - **Warranties and Guarantees**
  - **Termination of Contract**

**II. Treatment of LOLs under Common Law**

- Freedom of Contract
- Judicial Precedent, supplemented by Statutes
- Tendency toward Detailed Language
- Certain Legal Constraints, including Public Policy – vary among jurisdictions

**III. LOLs in Civil Code Jurisdictions**

- More prescriptive provisions; less reliance on precedent
- Code contemplation for range of circumstances
- Somewhat simpler language
- See attached Summary

**IV. LOLs in Transactions with Government and Non-Government Entities**

- Detailed laws and regulations common globally
- Bidding & Tender Requirements
- Less Flexibility to Negotiate Terms
- Verifying whether or not Customer is a Government Entity
- Limited Dispute Resolution Options

**V. LOLs under Other Laws or Systems**

- Islamic Law: different approach to liabilities
- Mixed Systems: principally in Asia; evolving legal systems with mix of civil and common law bases
- UN Convention on Contracts for the International Sale of Goods

**VI. Enforceability of Limitations**

- Legal Defenses
  - Non-negotiated boilerplate/"standard terms
  - Non-fulfillment of Fundamental Obligation/Failure of Essential Purpose
  - Unconscionability
  - Battle of the Forms Problems
- Mandatory Exclusions
  - Willful Misconduct, "Dolo" or Intentional Acts
  - Fraud or Misrepresentation
  - Negligence or Gross Negligence
- Importance of Dispute Resolution Forum
  - Court versus Arbitration
  - "Home Cooking"
- Always Gray Areas

**VII. Drafting and Negotiating the Limitation of Liability Provisions**

- **Understanding the Applicable Law**
  - **Finding Local Counsel**
  - **Possible Use of Host or Neutral Country Law**
  - **Crafting the Language**
- **Consideration of the Landscape**
  - **Cultural and Local Practices**
  - **Importance of Knowing your Customer**
  - **Language and Translation Issues**
  - **Legalistic versus Commercial Orientation**
  - **Standard Industry Practices/Competitive Situation**
- **Contractual Exceptions To Limitation Of Liability Provisions**
  - **Indemnities**
  - **Basic Warranties**
  - **Intellectual Property Infringement**
  - **Confidentiality**
  - **Mention/Acknowledge Legally Mandated Exclusions to Limitation of Liability Provisions?**
- **Relationship of LOLs to Other Contract Provisions**
  - **Governing Law**
  - **Dispute Resolution**
  - **Contract Price and Payment**
  - **Insurance**
  - **Severability**
  - **Review Entire Contract, including “Notwithstanding anything to the contrary...” and “Except as expressly stated in this Contract...” language**
- **Compromise Postions with Customers**
  - **Reciprocal Limitations: Equality v. Applicability**
  - **Cost-Sharing**
  - **“Multiple Strikes” Provisions**

**VIII. Internal Management Approvals for Limitations of Liability**

- **Unlimited Liability**
- **LOL Contrary to Acceptable Standards**

**VIII. Consideration of Sample Language**

- A. Language for Business Customers**
- B. Negotiating with Government Entities - Australia, Canada and Mexico**

APPENDIX A

**LIMITATION OF LIABILITY FOR SALES OF GOODS  
UNDER CIVIL LAW**

**I OVERVIEW OF CIVIL LAW**

- Civil law is based on Codes
- Code of Obligations
- Mandatory versus default provisions
- Other codes, which apply to a contract, even though not mentioned in the contract

**II GENERAL APPROACH OF CIVIL LAW TO LIMITATIONS OF LIABILITY**

- Sale of goods
- What is foreseen in the Code with regard to liability
- How much can be excluded in the liability clause

**III SAMPLE LANGUAGE OF LIMITATION OF LIABILITY CLAUSE**

- Paragraph of limitation of liability in sales contract

**IV STANDARD FORM CONTRACTS AND GENERAL CONDITIONS**

## I OVERVIEW OF CIVIL LAW

- **Civil law is based on Codes**

The continental legal system (private law) is based on the Constitution and Codes, which provide the basic legal structure. The meaning of the Codes is found in Commentary (which include case decisions) as well as newer case decisions by the courts.

In most countries the following basic Codes can be found: Civil Code, Civil Procedure Code, Commercial Code, Criminal Code, Criminal Procedure Code.

Commentaries are not a formal source of law. Commentaries are scholarly doctrines. The legislature and judges however defer to doctrine.

Case decisions have no stare decisis effect but cases are often consulted and commonly followed. They are most influential in new areas of law

- **Code of Obligations**

The law of obligations lays the foundation for all aspects of legal relations in civil and proprietary rights. Thus the founding, content, development and ending of such legal relations are catered for by the law of obligations, and the rules cover the equivalent of contract, tort and quasi contract (unjustified enrichment). The Code of Obligations contains the general provisions, which are applicable to all contracts, which are not specifically listed in the second part. The special part concerns the individual types of obligational relationships. If a specific contract is not listed in the second part, the general provisions of the first part apply. The general provisions are very detailed.

Not all contracts correspond exactly to the listed contracts in the Code of Obligations and many are mixed contracts, which overlap the categories. Additionally, new forms of business relations have come into being which were not envisaged at the time the Code of Obligations was drafted, such as factoring and franchising. The rules applicable are usually determined by the type of main obligation imposed by the agreement.

- **Mandatory versus default provisions**

The rules are provided by the legislature for parties, who have not, for whatever reason, formulated their own rules. Although contractual freedom is extensive, the mandatory rules must be observed.

Most provisions in the Code of Obligations are default provisions. This means, that they do only apply in case the contract between the parties has not foreseen anything else. Few provisions are mandatory and do apply even though the contract has stated something different. Mandatory provisions can be found in areas, where one party has to be protected, e.g. labor law, unjustified enrichment and unlawful conduct.

- **Other codes, which apply to a contract, even though not mentioned in the contract**

Depending on the contract, other Codes apply to the contract – besides that the “extra-contractual” Codes always apply. Such Codes are for example the Code for (unfair) General Terms and Conditions, the Product Liability Code, Copyright Code, etc.



## II SALE OF GOODS: GENERAL APPROACH OF CIVIL LAW TO LIMITATIONS OF LIABILITY

- **Sale of goods**

Every Code of Obligations in continental Europe has specifically listed the sales of goods contract. The sales contract is a bilateral obligation whereby the seller delivers the object to the buyer, who is obliged to pay the price. The “obligating” transaction is the agreement which gave rise to the contract in the first place, and creates the right of obligations of the parties and refers only to the establishment of the principal duties or obligations, the promise to sell something in exchange for a promise to pay. The “performance” transactions deal with the actual transference of the subject matter and money.

- **What is foreseen in the Code with regard to liability**

The seller's liability falls into two categories: Liability for legal defects concerning warranties of title and liability for defects in the quality of goods.

**The seller's liability for a defect in quality:**

The code foresees, that the seller warrants, that upon delivery the object is free from material defects that diminish or destroy its value, and that the object is fit for the purpose for which it was sold and is up to the promised quality. Faults are objective and subjective. Where the object sold deviates from the normal quality of an object of the same type that is an objective fault. Subjective fault may be relevant where an object, although for normal circumstances free from fault, was purchased for a specific purpose and is unable for whatever reason to fulfill that purpose. The seller is thus liable for the lack of a promised or ensured characteristic, which can be express or implied. Already by law foreseen, is the exclusion of liability, where the buyer was aware of the fault prior to conclusion of the contract, or he was grossly negligent in respect of the obvious fault and there was no duty on the part of the seller to inform.

**Remedies:**

The remedies for breach of the above mentioned liabilities are the cancellation of the sale, which involves the return of goods and the return of the price paid, or a reduction of the price paid or to be paid. The reduction in price is calculated on the basis of the market value of the defective object. All other obligations under the contract remain. The remedies of rescission or damages for non-performance are not available because the main duties have been performed.

The dividing line between defect and mistake can be very thin but most courts in Europe have decided, that in case where certain qualities are lacking, the remedy is not rescission, but only the reduction in price.

**Lack of promised characteristic**

A claim for non-performance exists when the object delivered lacked a promised characteristic or a defect was deceitfully concealed. This includes deliberate concealment of the fault, which includes the buyer to think the object has certain

qualities, which in fact it lacks. Such an omission would in any case breach the duty to perform in good faith.

Quality defects often concern the subjective perceptions of the parties, which the courts must consider. With generic goods this usually causes no problems because they have fairly clear qualities. Should the duty be breached, then damages will be available. This applies to extra and implied guarantees given which clearly form a fundamental part of the contract. Liability thus stems directly from this and does not require fault or responsibility to be shown. Such promises must be distinguished from pre-contractual salesman talk, which includes trade description or advertisements. They must involve specific individual claims that certain qualities exist, for example, in car sales, the mileage on odometers.

The compensation for the buyer is to put him in the same position as if the contract was performed successfully, the positive interest. This has been interpreted in the courts to cover claims for damages for resultant consequences of lack of promised quality.

If the buyer knowingly accepts the defective good, liability is excluded by law, unless a previous reservation of his rights has been made in the contract.

Special rules exist in respect to generic goods, whereby further rights can be exercised by the buyer. Generic goods are generally speaking goods, which are mass-produced. For generic goods, the law foresees, that in case they have a defect or lack of quality, they can be returned and a defect-free good can be demanded.

### **Tort Liability**

In most continental legal systems, delict is another form of obligational relationship, which establishes a claim against the vendor. This area of law is mainly concerning the liability from accidents. It is largely based on the objective of shifting, where possible, the cost of harm to those responsible, and complements unjust enrichment by rectifying an unjust loss rather than eliminating an unjust enrichment.

In most countries, there are three different aspects of this delictual liability. Liability arises as a result of injury in an unlawful and blameworthy manner, which violates a legal interest of the victim, the contravention of a protective law or intentional unlawful damage.

### **Remedy**

The wrongdoer is obliged to pay compensation for either negligent or intentionally violating the protected right of another. Three elements are required to establish unlawful conduct:

- a) There must have been an act that has violated an interest and caused damage
- b) The violation of the right should be unlawful and not be justified and
- c) It must have caused by either intentional or negligent fault.

### **Infringement Of A Protective Law**

A compensation is payable when a statute which serves to protect the rights of others is infringed.

### **Product Liability**

Based on the Product Liability Act, strict liability is imposed on manufacturer of a defective product, that kills or injures a person or which damages property.

- **How much can be excluded in the liability clause**

Other than tort liability, liability can be excluded, as long as the general principles of the laws are followed (e.g. taking unfair advantage).

## **III SAMPLE LANGUAGE OF LIMITATION OF LIABILITY CLAUSE**

- **Paragraph of limitation of liability in sales contract**

In the absence of a liability clause the above mentioned mandatory provisions would apply to the contract. Even though the law foresees the regulation of liability, it is advisable to state the liability clauses in the contract. Also, due to the fact, that in case of non-excludable tort-liability, negligent liability can be distinguished as between gross and ordinary negligence. Ordinary negligence can be excluded.

In most countries a clause like the one below will work, although the different legal aspects of each country have to be taken into consideration. Variations of the below text are therefore most likely.

**The Company accepts unlimited liability for damage that results from breach of duty involving intent or gross negligence.**

**With negligent violation of essential contractual obligations, liability shall be limited to the typically contractual, reasonably predictable damage resulting from the cancellation of the Agreement.**

**The Company accepts unlimited liability for damage arising from death, injury or damage to health resulting from negligent violation of contractual obligations.**

**However, the Company shall decline liability for damage, except in the case of intent and gross negligence, if the customer could reasonably have avoided such damage through suitable measures, in particular software and data backups, adequate training of users, etc. With loss or damage to data, the guarantee shall be limited to the cost of the duplicating of such data from machine-readable backup copies produced and made available by the customer.**

## **IV STANDARD FORM CONTRACTS AND GENERAL CONDITIONS**

The General Code of Obligation assumes the parties of equal strength have the autonomy to create contracts as they wish. This is not very realistic. In a large majority of business contracts, the will of one of the parties is often completely subjugated by the other party by use of standard contracts and business conditions.

On this ground, the General Conditions of Business Act (or similar) has become law in most countries. This law is only applicable to consumers. The general principles are as follows:

- Outlaws the “deem to know” clauses and prescribes that standard terms only become part of the contract where either express reference has been made to them, or the other party is given a reasonable opportunity to consider them and accept them.
- Outlaws surprise or unusual clauses, which cannot become part of the contract
- Contra proferentem rule

**Appendix B**  
**Sample "Common Law" Limitation of Liability Language**

PURCHASER EXPRESSLY AGREES THAT NEITHER COMPANY NOR ITS SUPPLIERS WILL UNDER ANY CIRCUMSTANCES BE LIABLE UNDER ANY THEORY OF RECOVERY, WHETHER BASED IN CONTRACT, IN TORT (INCLUDING NEGLIGENCE AND STRICT LIABILITY), UNDER WARRANTY, OR OTHERWISE, FOR: ANY INDIRECT, SPECIAL, INCIDENTAL OR CONSEQUENTIAL LOSS OR DAMAGE WHATSOEVER; DAMAGE TO OR LOSS OF PROPERTY OR EQUIPMENT; LOSS OF PROFITS OR REVENUE; LOSS OF USE OF PURCHASER'S MATERIAL, EQUIPMENT OR SYSTEMS; INCREASED COSTS OF ANY KIND, INCLUDING BUT NOT LIMITED TO CAPITAL COST, OR CLAIMS OF CUSTOMERS OF PURCHASER.

PURCHASER EXPRESSLY AGREES THAT THE REMEDIES PROVIDED HEREIN ARE EXCLUSIVE AND THAT UNDER NO CIRCUMSTANCES SHALL THE TOTAL AGGREGATE LIABILITY OF COMPANY UNDER ANY THEORY OF RECOVERY, WHETHER BASED IN CONTRACT, IN TORT (INCLUDING NEGLIGENCE AND STRICT LIABILITY), UNDER WARRANTY, OR OTHERWISE, EXCEED THE TOTAL PRICE PAID TO COMPANY UNDER THIS AGREEMENT.

THE PROVISIONS OF THIS ARTICLE SHALL PREVAIL OVER ANY CONFLICTING OR INCONSISTENT PROVISIONS SET FORTH ELSEWHERE IN THIS AGREEMENT.

*Note several points concerning this language. It has put into all capital letters to satisfy any requirement that it be conspicuous. If there is no such requirement, one should consider whether using capital letters makes the language stand out too much. There is a specific reference to negligence and strict liability to clarify that those items are covered. There is no reference to other possible mandatory exclusions to limitation of liability provisions, such as willful misconduct or fraud.*

**Appendix C**  
**Government Entity-Contract Terms on Liability**

**AUSTRALIA GOVERNMENT ENTITY-UNLIMITED LIABILITY CONTRACT TERMS**

**Liability of the Parties**

The Liability of a Party for Breach of this Contract, or in tort, or for any other common law or statutory cause of action arising out of the operation of this contract, shall be determined under the relevant law in Australia that is recognized, and would be applied, by the High Court of Australia.

The Liability of the Contractor for loss of, or damage to, the data of Government Entity shall be reduced proportionally to the extent of Government Entity's failure to comply with its obligations and responsibilities under clause 24, provided that such failure is not caused by, or contributed to, by any act or omission of the Contractor.

**CANADA GOVERNMENT ENTITY-UNLIMITED LIABILITY CONTRACT TERMS**

**Liability And Indemnification:**

Contractor shall be liable to Government Entity and shall indemnify and save harmless Government Entity from claims and suits of third parties brought in contract or tort for claims arising from Contractor's performance or non-performance on the obligations of the Agreement. For such claims Contractor shall fully indemnify Government Entity for all its legal costs.

**Remedies of Government Entity:**

Upon the occurrence of a breach of the Agreement by the Contractor, Government Entity may choose from the following remedies as Government Entity, in its sole and absolute discretion, shall determine:

- (a) Government Entity may terminate this Agreement
- (b) Government Entity may bring an action at law as may be necessary or advisable in order to recover damages and costs.
- (c) If Government Entity terminates the Agreement or reduces its scope thereby depriving the right to complete any portion of the Project, Government Entity will then have the right, but not obligation, to complete the Project by whatever method Government Entity considers expedient. Government Entity may choose to do the Work itself or to remove or replace Contractor but to keep all or some of the subcontractors. In that event, Contractor shall assign specified subcontracts to Government or its designate at the option of Government Entity.
- (d) If Government Entity terminates the Agreement or reduces its scope and is forced to do all or part of the work itself or find replacement for Contractor with or without its subcontractors, Contractor shall bear the incremental costs associated with the change. Included in those incremental costs will be any margin making up the higher prices associated with the replacement by another supplier or by Government Entity employees, as well as an administration fee for the added administrative and legal burden of repeating the process of selection. If these

costs exceed the unpaid balance of the contract, Contractor will be liable for the balance.

**Non-Exclusive Remedies:**

Government Entity may, in its sole discretion, exercise any right or recourse and/or proceed by any action, suit, remedy or proceeding against Contractor authorized hereunder or permitted by law and may proceed to exercise any and all rights hereunder and no remedy for the enforcement of the rights of Government Entity shall be exclusive of any other rights or remedies provided hereunder or at law or in equity or be dependant upon any such right or remedy and any one or more of such rights or remedies may from time to time be exercised independently or in combination.

**MEXICO: LIABILITY LIMIT (Government Contract)**

Notwithstanding any provision to the contrary contained in this Contract, none of the Parties will be responsible for indirect or consequential losses or damages of any type, deriving or in any form relating to the fulfillment or unfulfillment of the obligations of this Contract. The Parties acknowledge that their contractual responsibility, in the terms of this Contract, may not exceed its total amount.

## Appendix D SAMPLE APPROVAL FORM

**FOREIGN GOVERNMENT CONTRACT REQUIRING ACME TO ASSUME UNLIMITED LIABILITY**

Submitted To:

Distribution:

Item	Information
Date:	
Acme Entity:	
Foreign Government Entity:	
Acme Employee Leading Transaction:	
Acme Employee Title:	
Phone:	
Products/Services to be sold and value:	
Maintenance:	
Professional Services:	
Projected Future Revenue:	
Acme Entity Comments:	
Any previous dealings with this Foreign Government entity?:	
Transaction Summary:	
Does the Acme entity currently have existing agreements with this entity or any related governmental entity or agency?:	
Risk Management Comments:	
Office of Corporate Counsel Comments:	

Approve – Disapprove (Circle One)

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Date

\_\_\_\_\_  
Printed Name

\_\_\_\_\_  
Title

Comments on approval or disapproval: