Enforceability of Limitation of Liability Clauses: Looming Uncertainty in France and the United States?

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The decision by France’s Cour de cassation (French Supreme Court) in Oracle v. Faurecia on February 13, 2007 confirmed the French Supreme Court’s willingness to deny the effect of limited liability clauses to parties who have breached essential obligations under contract. This noteworthy decision was the latest development in the Chronopost line of cases dating from October 22, 1996 which had established that limitation of liability provisions agreed contractually between two parties would be set aside where the postal carrier had breached its essential obligation under a contract for expedited mail delivery service.

The Cour de cassation’s recent ruling has extended that holding to apply more generally in various business to business settings, including, as in the present case, to a group of contracts involving the delivery and licensing of computer programs.

The Cour de cassation’s decision stemmed from a contract dispute between Oracle, the software company, and Faurecia, the automobile equipment supplier, whereby Oracle was to deliver a software program called V12 to Faurecia (Commercial Chamber of the Cour de cassation, February 13, 2007, n° 05-17,407). Oracle ultimately failed to deliver the program and came to rely on the contract’s limited liability clause which limited Faurecia’s remedy to the price paid under the contract.

The starting point of the Cour de cassation’s holding rests on its finding that Oracle had failed to perform an essential contractual obligation by failing to deliver the V12 program to Faurecia. This determination of the failure of essential obligation was made on an objective basis that did not require the subjective showing of gross misconduct on the part of the breaching party.

As between Oracle and Faurecia, the Cour de cassation held that Oracle’s inability to deliver the program without establishing an event of force majeure and without the parties agreeing to the delivery of an alternative program constituted a failure to perform the contract’s essential obligation such that the obligation of the limited liability clause itself became a nullity on grounds of the absence of cause.
In essence, under this latest holding a limited liability clause would be set aside based on the disappearance of contract’s cause stemming from one party’s failure to perform an essential obligation of the contract (unless the non-performance could be justified under a force majeure event or an otherwise agreed condition). This analysis grounded on cause naturally differs from the approach taken by U.S. courts.

The Issue Dividing the American Courts

American jurisprudence on limited liability clauses takes a different character as the issue is not that the party has failed to perform its essential obligation under the contract but that the limited remedy contracted between the parties has failed its essential purpose in remedying a breach anticipated between the two parties.

The American law concerning contractual modification or limitation of remedy is codified under Uniform Commercial Code §2-719 (“UCC”). The point of contention in the courts is the interplay between two statutory clauses that address limited liability clauses under this section of the Uniform Commercial Code. Clause 2 of UCC §2-719 provides that “Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act.” Clause 3 further provides that “Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable.”

“Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not.” The official comments to this section note that these provisions are intended to provide parties with the freedom to limit and shape their remedies according to their circumstances. UCC §2-719, Official Comment.

However, the freedom to contract is limited to the extent that the contract must give “at least minimum adequate remedies” for breaches of the contract obligations or duties. Where the limited remedy has failed of its essential purpose, the contracting party may also have recourse for other remedies provided elsewhere under the UCC. With regard to clause 3, the official comments note that the subsection “recognizes the validity of limiting or excluding consequential damages but makes clear that they may not operate in an unconscionable manner.”

The issue of how to interpret and apply these two provisions of §2-719 has divided the courts from coast to coast.

The point of contention between the courts is whether the clauses operate independently of each other such that a separate clause excluding consequential damages may still stand even if the limited remedy fails of its essential purpose. Some courts have asserted that where there is a failure of essential purpose, the accompanying clause that limits consequential damages is not voided per se.
The line of cases that follows this approach would interpret clauses 2 and 3 of §2-719 to operate exclusively of each other such that where a remedy fails its essential purpose, other limitations on consequential damages would remain intact except where the limitation or exclusion is found to be unconscionable.

Alternatively, other courts have ruled that the limited remedy clauses and consequential damages clauses should be interpreted such that the failure of one results in the failure of the other. The reasoning supporting this interpretation holds that a limited remedy clause based on failure of essential purpose would have little effect if remedies can be limited by a separate clause.