

Contract Corner: Limitations of Liability—Damages

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We recently discussed the structure and enforceability of limitation-of-liability provisions. In this Contract Corner post, we focus on different types of damages and issues to consider when deciding whether to exclude such damages.

For what types of damages could parties be liable?

Direct damages are generally interpreted to mean damages that naturally result from a breach of a contract. Direct damages put the nonbreaching party in the position of receiving its expected contract value as if the contract were fully performed in accordance with its terms. These “benefit of the bargain” damages are likely to be suffered by any person in the position of the nonbreaching party.

Consequential damages, on the other hand, are often distinctive to a particular nonbreaching party. Consequential damages are damages that proximately result from a breach of a contract. Consequential damages are also commonly referred to as “indirect damages” because they arise indirectly from a breach due to various events that flow from a breach. Consequential damages do not include remote or unforeseeable damages.

Incidental damages are expenses reasonably incurred by a nonbreaching party in connection with effecting cover (e.g., expenses incurred in finding replacement performance) or otherwise incident to the breach. Punitive damages are intended to punish and deter certain behavior and may not be tied to the relevant economic loss of the aggrieved party. Punitive damages are generally not available for breach of contract claims, but contract claims disguised as tort claims may lead to an award of punitive damages.

How should damages be excluded?

Contracts commonly exclude all incidental, indirect, and consequential damages, subject to certain exceptions that we will discuss in a future post. In addition, punitive damages may be expressly excluded because of the potential applicability noted above.

However, such broad categorical limitations of liability may not be optimal in many situations. For

example, the disclaimer would be over inclusive if excluding incidental damages is inconsistent with specific provisions in the contract (e.g., the supplier will cover all replacement costs of nonconforming goods, including return shipping costs). If parties otherwise intend to exclude incidental or other damages, one approach would be to carve out remedies expressly set forth in the contract from the limitation of liability.

Similarly, a disclaimer would be under inclusive if the parties intend that all lost profits should be excluded because some lost profits can be considered direct damages (e.g., lost profit on the resale of the undelivered product). If the disclaimer lists specific damages, such as lost profits, the parties should consider whether such damages should be listed independently or under the umbrella of consequential and other excluded types of damages.

As we noted in our previous post, enforcing limitation-of-liability provisions can become an issue under certain circumstances. To bolster the likelihood that limitations of liability will apply and be upheld, the disclaimer can include additional language, including the following:

- The limitations of liability apply regardless of the claim's basis (e.g., tortious or intentional conduct).
- The limitations of liability apply even if the breaching party has been advised of the possibility of such damages in advance (i.e., the damages were foreseeable).
- The limitations of liability apply notwithstanding any failure of essential purpose of any exclusive or limited remedy (e.g., the limited remedy for nonconforming goods is repair or replacement, and the supplier does neither). In case any limited remedy is eventually held to be unenforceable, the disclaimer should be in a separate section from the limited remedy, and the contract should include a severability clause so that the limitations of liability remain effective despite any such holding.

This post is part of our recurring "Contract Corner" series, which provides analysis of specific contract terms and clauses that may raise particular issues or problems. Check out our prior Contract Corner posts for more on contracts, and be on the lookout for future posts in the series.

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