

To what extent is the court taking a fluid approach to "consequential loss"; and so giving effect to the intention of the parties and the commercial freedom to negotiate risk?

White Paper:
Professional Negligence
Conference

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Direct and Consequential Loss

- Hadley v Baxendale (1854) 9 Ex 341, Alderson B at 355:

“Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it”.

Direct Loss

- Hadley v Baxendale – Limb One.
- Losses arising naturally in the ordinary course of things.
- Direct losses are foreseeable and recoverable, not too remote.
- Can include (depending on the facts):
 - Physical damage;
 - Loss of profits;
 - Unlimited economic loss; or
 - Damage to reputation or goodwill.

Indirect or Consequential Loss

- Hadley v Baxendale – Limb Two.
- Losses that may reasonably be supposed to have been in the contemplation of the parties at the time they made the contract, as a probable result of the breach.
- If the contract-breaker was aware of the special circumstance when the contract was made, indirect losses are foreseeable and recoverable.
- If not, they are too remote.
- Can include (depending on the facts):
 - Physical damage;
 - Loss of profits;
 - Unlimited economic loss; or
 - Damage to reputation or goodwill.

Direct and Consequential Loss

- Victoria Laundry and The Heron II
- Asquith LJ at 540 in Victoria Laundry
- *“Everyone, as a reasonable person, is taken to know the “ordinary course of things” and consequently what loss is liable to result from a breach of contract in that ordinary course. This is the subject matter of the “first rule” in Hadley v. Baxendale .*
- *But to this knowledge, which a contract-breaker is assumed to possess whether he actually possesses it or not, there may have to be added in a particular case knowledge which he actually possesses, of special circumstances outside the “ordinary course of things,” of such a kind that a breach in those special circumstances would be liable to cause more loss. Such a case attracts the operation of the “second rule” so as to make additional loss also recoverable.”*

Exclusion Clauses

- BHP Petroleum Ltd v British Steel plc
- Rix J at 597
- *“What however, is to happen where the Hadley v. Baxendale rule is used as the critical test of what are “consequential losses” for the purposes of an exclusion in those terms? If any loss which, on the facts of the case, is within the contemplation of the parties is treated as being within the first limb of the rule, then the exclusion is redundant and useless. How does one tell the difference between losses which are within the contemplation of the parties within the first limb, and other losses which are only within the contemplation of the parties because of special knowledge within the second limb?”*
- Lord Hoffman, 2010 at the University of Edinburgh
- *“For my own part I think that, although an excellent attempt was made in Hadley v Baxendale to lay down a rule on the subject (ie, recoverable damages), it will be found that the rule is not capable of meeting all cases; and when the matter comes to be further considered, it will probably turn out that there is no such thing as a rule, as to the legal measure of damages applicable in all cases.”*

Star Polaris and Transocean Drilling

- A more pragmatic approach towards defining “consequential damages?”
- Giving effect to the commercial intentions of the parties
- Reduced role for judicial interpretation where the intentions of the parties are clear.
- Overall objective to allow parties the commercial freedom to negotiate.
- An eventual erosion of the rule in Hadley v Baxendale?

Professional Liability (I)

■ Construction Professionals

- Potentially large exposures
- Project owner will want unlimited liability; contractor or construction professional to limit liability for consequential losses.
- Star Polaris and Transocean Drilling – Be as explicit as possible in any exclusion clause!

Professional Liability (II)

■ Solicitors

- Myriad forms of consequential loss which are often covered by existing case law.
- Star Polaris and Transocean nevertheless deserve study when drafting any exclusion clause in an engagement letter.

■ Accountants and Auditors

- Numerous forms of loss such as lost investments, overpayment, late filing fees and loss of profits.
- *Price Waterhouse v University of Keele* shows the difficulties of using the term “consequential loss” within an exclusion clause.
- Use a “schedule of loss” or some other form to specify the loss that is actually excluded.

Professional Liability (III)

■ Insurance Brokers

- Consequential loss most common where a client has not received a payment from his insurer.
- *Ramwade Ltd v WJ Empson & Co Ltd* a more generous interpretation of consequential loss towards a contract breaker?
- Business interruption insurance exception
- Insurance broker may be able to be more immune to the poorly drafted exclusion clause.

International Context

■ New York Case Law

- New York Case Law - *Biotronik AG v Conor Medasystems Ireland Ltd* – Reversal of the traditional position under New York law that loss of profits will automatically be consequential loss.
- Australian Case Law – *Regional Power Corp v Pacific Hydro Group Pty (No 2)* has moved beyond *Hadley v Baxendale*.
- Trend for common law jurisdictions - Usual principles of contractual interpretation are deployed in a pragmatic way looking at the commercial intentions of the parties.

Conclusion

- Hadley v Baxendale not obsolete
- Star Polaris and Transocean Drilling however do emphasize that, where possible, the courts will give effect to the commercial intentions of the parties,
- However, where an exclusion clause is ambiguous – the usual contractual interpretation rules and Hadley v Baxendale will still apply.
- Main point for drafting lawyers – ensure you specify the extent of your liability!



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