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Consequential loss

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The question

- 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?

Traditional approach

- Clauses in commercial contracts excluding liability for consequential losses are to be construed by reference to the 2 limbs of *Hadley v Baxendale*

- *"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*

  [1] arising naturally, i.e. according to the usual course of things, from [the] breach of contract itself, or

  [2] 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."

So:

- *"consequential"* or *"indirect or consequential"* losses have long been recognised as meaning losses which are not the direct and natural result of the breach

- *Ferryways NV v Associated British Ports* [2008] EWHC 225:

"In the light of the well-recognised meaning…accorded to such words…by the courts from 1934 to 1999 it would require very clear words indeed to indicate that the parties' intentions when using such words was to exclude losses which fall outside that well-recognised meaning…."

Trenchant criticism

McGregor on *Damages*, 19th Ed:

- The cases support giving to the term *"consequential loss"* the meaning which confines it to 2nd limb of *H v B*
- *"The whole approach…is to be deprecated"*
- *"It is also illogical and fails to make practical sense"*
- *"contradictory for one contracting party to communicate special circumstances to the other so as to fix him with a liability for loss to which he would not otherwise be subject and at the same time to accept an exclusion of liability in respect of the selfsame loss"*

A new approach – *Transocean Drilling*

Transocean Drilling UK Ltd v Providence Resources PLC [2016] EWCA Civ 372

- Claim for "spread costs" (wasted costs of 3rd parties)
- Long and detailed definition of consequential loss and each party indemnified the other against its own consequential losses
- Issue: whether spread costs were consequential losses

For the purposes of the Clause 20 the expression "Consequential Loss" shall mean:

I. *Any indirect or consequential loss or damages under English law, and/or*

II. *To the extent not covered by (i) above, loss or deferment of production, loss of product,* ***loss of use (including, without limitation, loss of use or the cost of use of property, equipment, materials and services including without limitation those provided by contractors or subcontractors of every tier or by third parties)****, loss of business and business interruption, loss of revenue …, loss of profit or anticipated profit, loss and/or deferral of drilling rights and/or loss restriction or forfeiture of license, concession or field interests,*

whether or not such losses were foreseeable at the time of entering into the CONTRACT and in respect of paragraph (ii) only, whether the same are direct or indirect …

… Notwithstanding any other provisions of the CONTRACT to the contrary the Company shall save, indemnify, defend and hold harmless the CONTRACTOR's GROUP from the COMPANY GROUP's own consequential loss and the CONTRACTOR shall save, indemnify, defend hold harmless the COMPANY GROUP from the CONTRACTOR GROUP's own consequential loss.

Court of Appeal decision:

- Since *Photo Production Ltd v Securicor*, courts have recognised that artificial approaches to construction of commercial contracts are to be avoided in favour of giving the words used their ordinary and natural meaning

- The expression "consequential loss" has caused a certain amount of difficulty for English lawyers – questionable whether some of cases would be decided in the same way today (but not necessary to decide)

- *Contra proferentem* had no role – words clear, clause favours both parties equally, parties of equal bargaining power

- The principle of freedom of contract requires the court to respect and give effect to the parties' agreement

- It cannot be said that contract is devoid of legal content just because the parties have agreed not to recover consequential as opposed to direct loss

- No reason why commercial parties should not be free to embark on a venture of this kind on the basis of an agreement that neither will be liable to the other for consequential loses, however they choose to define them

- Sophisticated allocation of losses
- Striking feature of contract is extent to which parties agreed to accept responsibility for losses
- Mutual nature of clause 20 and its role as part of the provisions for allocating loss tell in favour of an intention to give the words a broad meaning
- Natural meaning of words “loss of use” includes wasted spread costs

The Star Polaris [2016] EWHC 2941

Article IX.4 - Extent of BUILDER's Liability

(a) After delivery of the VESSEL the responsibility of the BUILDER in respect of or in connection with the VESSEL or this CONTRACT shall be limited to the extent expressly provided in the Paragraph 4 of this Article. Except as expressly provided in this Paragraph, in no circumstances and on no ground whatsoever shall the BUILDER have any responsibility or liability whatsoever or howsoever arising in respect of or in connection with the VESSEL or this CONTRACT after the delivery of the VESSEL. Further, but without in any way limiting the generality of the foregoing, the BUILDER shall have no liability or responsibility whatsoever or howsoever arising for or in connection with any consequential or special losses, damages or expenses unless otherwise stated herein.

- It was argued that the Court was bound by the established meaning of consequential losses i.e. the 2nd limb of *Hadley v Baxendale*

BUT:

- The clause provided a complete code

- *"consequential or special"* losses did not mean 2nd limb of *H v B* but had the wider meaning of financial losses caused by guaranteed defects, above and beyond the cost of replacement and repair of physical damage

- Claim for diminution in value was also a claim for consequential or special loss – even though it might well have fallen within the 1st limb of *H v B*

- Obligation to repair /replace was exhaustive and nothing else was recoverable above and beyond that

And also…. *Bluewater Energy Services BV v Mercon* [2014] EWHC 2132

"For the purpose of this Clause 25 the expression "Consequential Loss" shall mean loss and/or deferral of production, loss of product, loss of use, loss of revenue, profit or anticipated profit (if any), in each case whether direct or indirect, and whether or not foreseeable at the EFFECTIVE DATE OF COMMENCEMENT OF THE CONTRACT.

Notwithstanding any provision to the contrary elsewhere in the CONTRACT and except to the extent of any agreed liquidated damages provided for in the CONTRACT, BLUEWATER shall save, indemnify, defend and hold harmless the CONTRACTOR GROUP from the BLUEWATER GROUP's own Consequential Loss and the CONTRACTOR shall save, indemnify, defend and hold harmless the BLUWATER GROUP from the CONTRACTOR GROUP's own Consequential Loss."

- Reliance on meaning of consequential losses in decided cases of no assistance
- Parties have agreed their own definition and broadened it to avoid any distinction between direct and indirect loss
- The definition clearly applied to loss of profit arising from a wrongful termination

Fluid and flexible?

- *"The pathway to a new approach has been paved……"* (McGregor)
- Certainly more flexibility
- But necessary to draw up a complete code, have a sophisticated allocation of losses, accept full responsibility for defined losses?
- Still beware simple references to *"consequential loss"* or *"indirect or consequential loss"*?

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Thank you for listening

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