



CONSEQUENTIAL LOSSES

TIPTOEING THROUGH THE MINEFIELD

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What is consequential loss?

In many commercial contracts, business people will seek to exclude any liability for consequential losses arising out of a breach of contract.



What is consequential loss?

The ordinary businessman or woman can be forgiven for believing that “consequential loss” includes loss of earnings, loss of production, and loss of profit.



What is consequential loss?

And, in the unlikely event that he/she reads para.1-036 of McGregor on Damages (18th Ed.), support for those beliefs would be found in the following:-

“... In contract the normal loss can generally be stated as the market value of the property, money or services that the claimant should have received under the contract, less either the market value of what he does receive or the market value of what he would have transferred but for the breach. Consequential losses are anything beyond this normal measure such as profits lost or expenses incurred through the breach and are recoverable if not too remote ...”

But, cf. McGregor on Damages (19th Ed.) in which this passage does not appear.



What is consequential loss?

The reasonable businessperson might therefore reasonably conclude that a clause which expressly excludes liability for consequential losses will exclude liability for loss of earnings, loss of production and loss of profit.



What is consequential loss?

The reasonable businessperson might therefore reasonably conclude that a clause which expressly excludes liability for consequential losses will exclude liability for loss of earnings, loss of production and loss of profit.

He or she, however, would be wrong. The English courts have taken a very different approach to the meaning of consequential loss.



What is consequential loss?

- What have the courts told us it is?
 - Consequential loss is any loss which does not directly and naturally result in the ordinary course of events from the breach of contract.
 - In other words it is “indirect loss” - loss which would only be recoverable under the second part of *Hadley v Baxendale*.
 - See *Croudace v Cawoods* [1978] 1 Lloyd’s Rep. 55



What is consequential loss?

- To construe “consequential loss” in this way
“gives it a sensible and workable and valuable meaning which appears to me to accord with commercial sense and probably commercial intention”: see Parker J. in *Croudace* at p.59.



What is consequential loss?

- To construe “consequential loss” in this way
“gives it a sensible and workable and valuable meaning which appears to me to accord with commercial sense and probably commercial intention”: see Parker J. in *Croudace* at p.59.
- And to underline this:-
“... once a phrase has been authoritatively construed by a court in a very similar context to that that which exists in the case in point, it seems to me that a reasonable businessman must more naturally be taken to having the intention that the phrase should bear the same meaning as construed in the case in point. It would again take very clear words to allow a court to construe the phrase differently ...” *British Sugar plc v NEI Power Products* [1988] 87 BLR 42



What is consequential loss?

- This is not, however, every judge's view of commercial sense
"One would like to say simply that all consequential losses are recoverable provided they were either objectively or subjectively foreseeable by the parties; but to do this is to restore to the word "consequential" the natural meaning of which commercial and legal usage in exclusion clauses has long since robbed it": *Hotel Services Ltd v Hilton International Ltd* [2000] BLR 235, 239, per Sedley L.J.
- See Lord Hoffman in *Caledonia North Sea Ltd v British Telecom plc* [2002] 1 Lloyd's Rep. 553 @ para.100.
- McGregor on Damages (19th Ed) at paras. 3.12-3.12; *Environmental Systems Pty Ltd v Peerless Holdings Pty Ltd* [2008] VSCA 26; *Alstrom Ltd v Yogowawa Australia Pty Ltd* [2012] SASC 49



What do “consequential losses” not include?

- Loss of earnings
- Loss of production
- Loss of profits.
- All of these would ordinarily fall within the first limb of *Hadley v Baxendale* – they are not unusual losses for which the defaulter could only be liable if made aware of the danger of their being suffered.
- So an exclusion clause which seeks to exclude “consequential losses” only will **not** exclude these heads of loss – the very heads of loss which any businessperson would wish to have excluded and would ordinarily consider to be consequential losses.



What do “consequential losses” not include?

- Many exclusion clauses purport to exclude “indirect and consequential losses”.
- The unsuspecting businessperson will consider that loss of profits and production fall within these heads. He/she will be wrong to do so.
- If you have an exclusion which excludes “indirect and consequential losses only”
 - “... the clause may in some – perhaps many – cases exclude nothing; but in others it may afford valuable protection ...” Croudace (above) per Parker J. at 59



Clauses seeking to exclude loss of profits etc.

- There have been a number of cases in which the Courts have considered clauses that were evidently drafted in an attempt to avoid the narrow meaning given to “consequential losses”.
- The judges do not speak with one voice - very different conclusions have been reached on not dissimilar clauses.



Deepak v ICI [1999] 1 Lloyd's Rep. 387, CA

“In no event shall Davy by reason of its performance or obligations under this Contract be liable in tort or for loss of anticipated profits, catalyst, raw materials and products or for indirect or consequential damage”



Deepak v ICI [1999] 1 Lloyd's Rep. 387, CA

“In no event shall Davy by reason of its performance or obligations under this Contract be liable in tort or for loss of anticipated profits, catalyst, raw materials and products or for indirect or consequential damage”

- The CA overturned Rix J.'s decision that fixed costs and overheads incurred by reason of the destruction of a methanol plant were excluded.
- It did, however, conclude that “lost profits cannot be recovered because they are excluded in terms” (at para. 91).



BHP Pet. v British Steel [1999] 2 Lloyd's Rep. 583

“Neither the supplier nor the purchaser shall bear any liability to the other (and each hereby agrees to indemnify the party relying on this provision) for loss of production, loss of profits, loss of business or any other indirect losses or consequential damages arising during and/or as a result of the performance or non-performance of this Contract”



BHP Pet. v British Steel [1999] 2 Lloyd's Rep. 583

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- This Clause purports to exclude loss of production etc.
- But it then goes on to say or “any other indirect losses or consequential damages.
- Do those last words qualify the earlier words?



BHP Pet. v British Steel [1999] 2 Lloyd's Rep. 583

“Neither the supplier nor the purchaser shall bear any liability to the other (and each hereby agrees to indemnify the party relying on this provision) for loss of production, loss of profits, loss of business or any other indirect losses or consequential damages arising during and/or as a result of the performance or non-performance of this Contract”

- Rix J held not and that the clause should be read as if it had said

“... loss of production, loss of profits, loss of profits, loss of business or indirect losses or consequential damages of any other kind ...”

- He accepted the argument that the partes may have been in error to permit the inference that the former phrases are all examples of indirect or consequential loss.



BHP Pet. v British Steel [1999] 2 Lloyd's Rep. 583

- Rix J. concluded that

“at least in that way each of the phrases is given its authoritative meaning, which is what the parties must have been supposed to have given their closest attention to. If, however, only production, profit, or business which is within the second limb of *Hadley v Baxendale* is intended to be referred to, then everything in the clause other than “indirect losses or consequential damages” becomes redundant and the previous phrases become dangerously misleading and potentially valueless ... (at p.600)”



The Herdentor (1996 - unreported), Clarke J

Clause 18(3) of Towcon 1985, excluding

“... loss of profit, loss of use, loss of production or any other indirect or consequential damage ...”



The Herdentor (1996 - unreported), Clarke J

Clause 18(3) of Towcon 1985, excluding

“... loss of profit, loss of use, loss of production or any other indirect or consequential damage ...”

- Clarke J held that the loss there claimed (the diminution of a salvage award due to breach of Towcon) did not fall within the meaning of “loss of profit”.
- But, **obiter**, he considered that cl.18(3) did not exclude direct losses of profit, use etc. They only excluded indirect losses of profit etc. In other words the later words “any other” qualified the earlier words.
- This arguably renders the earlier phrases dangerously misleading and potentially valueless – this case was not cited in BHP.



Ease Faith v Leonis Marine [2006] 1 Lloyd's Rep. 673

Towcon Clause 18.3 again

"... loss of profit, loss of use, loss of production or any other indirect or consequential damage ..."

- Delay in performance of tow leading to delay in delivering a scrap vessel and consequent reduction in purchase price.
- Owners claimed damages from tugowners for that reduction.



Ease Faith v Leonis Marine [2006] 1 Lloyd's Rep. 673

- Andrew Smith J. held that the “loss of profits” exclusion only referred to loss of profits generated by future use of the tug or tow and that the owners’ claim was not therefore excluded by clause 18.3.
- He also observed, obiter, that the reasoning of Clarke J in *The Herdentor* was to be preferred to that of Rix J. in *BHP*, saying
“... it is true that loss of profits is capable of being a direct loss, but it need not be. For my part I do not find it remarkable that parties seeking to exclude all indirect loss but being particularly concerned about indirect loss or profit should agree upon a provision that makes specific reference to loss of profits ... (para.149)”



Ease Faith v Leonis Marine [2006] 1 Lloyd's Rep. 673

- The fact that BIMCO subsequently amended clause 18(3) in Towcon 2008 and Towhire 2008 shows that the industry's understanding of what the clause should mean was perhaps rather different from that of Andrew Smith J. and Clarke J.
- The relevant provisions now provide that neither the Tugowner nor the Hirer shall be liable to the other party for
 - “ ... i. any loss of profit, loss of use or loss of production whatsoever and whether arising directly or indirectly from the performance or non-performance of this Agreement ..., or
 - ii. any consequential loss or damage for any reason whatsoever ...”



Ferryways NV v ABP [2008] 1 Lloyd's Rep. 639

Stevedoring contract.

“... where the Company is in breach of its obligations ... it shall have no liability to the Customer ... for any loss, damage, costs or expenses whatsoever incurred or suffered by the Customer which is of an indirect or consequential nature , including without limitation the following:

- (i) loss or deferment of profit;**
- (ii) loss or deferment of revenue;**
- (iii) loss of goodwill**
- (iv) loss of business etc etc ...”**



Ferryways NV v ABP [2008] 1 Lloyd's Rep. 639

“... where the Company is in breach of its obligations ... it shall have no liability to the Customer ... **for any loss, damage**, costs or expenses whatsoever incurred or suffered by the Customer **which is of an indirect or consequential nature**, including without limitation the following ...”

- Teare J held that “indirect and consequential” had acquired a well-recognized meaning in cases such as *Croudace* and *Deepak*, although the scope of the exception depended upon the construction of the particular clause.
- In light of the clear meaning given to indirect and consequential (particularly “indirect”, which draws an implicit distinction with direct losses) the clause only excluded second limb losses.



Fujitsu Services v IBM [2014] EWHC 752

“... Neither party shall be liable to the other under this Sub-Contract for loss of profits, revenue, business, indirect or consequential loss or damage ...”

Fujitsu argued that this provision was not apt to exclude direct loss of profits etc.



Fujitsu Services v IBM [2014] EWHC 752

“... Neither party shall be liable to the other under this Sub-Contract for loss of profits, revenue, business, indirect or consequential loss or damage ...”

Carr J held (at paras.72-82)

- That *Ease Faith*, *The Herdentor* and *BHP* were not relevant because the clauses in each of those cases contained the word “other”;
- There was no justification for construing/rewriting the clause to limit the basic exclusion to indirect and consequential loss – one would expect it to be made clear if the intention was only to exclude indirect loss of profit and Fujitsu’s construction would render otiose the words “loss of profits, revenue, business ...”



Arbitration Award (2007)

“... In this clause

“consequential loss” shall mean all indirect loss or damages including but not limited to, loss of contract, loss of profit, loss of production, loss of revenue, loss of savings, loss of use, or business interruption, howsoever caused, arising out of or in connection with the Contract and whether or not foreseeable at the date of the Contract ...

... Notwithstanding anything expressed or implied in the Contract to the contrary

a) neither the Purchaser nor the Contractor shall be liable to the other for the other’s consequential loss ...”



Arbitration Award (2007)

The very distinguished Tribunal concluded that loss of profit and production was excluded.

- Each clause had to be construed according to its own terms (as in *Deepak and BHP*);
- Although consequential loss was defined to mean “all indirect, loss or damage” the parties agreed that this included loss of profit and loss of production ... howsoever caused/whether or not foreseeable.
- The clause clearly straddled both limbs of *Hadley v Baxendale*.
- It is common (if not invariable) that loss of production and loss of profits is excluded from many English and international process contracts”.



What does this all mean?



What does this all mean?

- Who knows?



What does this all mean?

1. Each contract must be construed according to its own terms.
2. If a clause simply excludes consequential losses then loss of profits, production etc. will **not** be excluded.
3. If a clause excludes “loss of profits etc. **and** indirect or consequential losses” then loss of profits etc. will probably be excluded: *Deepak; Fujitsu*.
4. If a clause excludes “loss of profits etc. and **other** indirect or consequential losses” then there is a divergence of opinion as to whether direct loss of profits etc. is excluded:
 - *BHP* (not obiter) says they are excluded;
 - *The Herdentor* and *Ease Faith* (both obiter) say not.



What does this all mean?

5. How the “other” construction would be decided if the point were to go to court again is anybody’s guess. This is likely to depend upon who hears the case.
6. One would hope that ordinary business commonsense would prevail (see Lord Clarke in *The Rainy Sky*) as it did in *BHP* and in the arbitration award referred to above. One might, however, be disappointed.



Drafting: If you want to exclude loss of profit etc.

1. Try and avoid any reference to consequential loss, steer away from any mention of indirect losses and run a mile from qualifying words such as “other”. E.g.

X shall not be liable for any loss of revenue, production, profit or anticipated profit arising under or in connection with this contract.

2. If you do need to mention consequential losses then define these for the purposes of the contract and add words to the effect of “howsoever caused and whether or not foreseeable at the time of making the contract”



And if you don't want to exclude loss of profit etc.

1. Simply exclude any "indirect or consequential losses"; or
2. If you are asked to draft a clause which refers to loss of profits etc. then draft a clause along the lines of *Ferryways* which excludes indirect and consequential losses of the following nature ... loss of profits etc.



THANK YOU

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September 2014

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