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CONSEQUENTIAL AND INDIRECT LOSS

24 September 2020

BEN QUINEY QC

Crown Office Chambers

Topics

- Introduction
- Typical wordings
- Interpretation
- Orthodox position
- Scope for change



Introduction

- This issue arises because contracts often contain exclusion clauses that seek to exclude certain types of losses.
- This can include losses described as “indirect” or “consequential” losses.
- The difficulty arises from established case law that appears to anchor such clauses to the rule set out in *Hadley v Baxendale* (1854) 9 Ex 341.
- This appears to be inconsistent with both principles of interpretation and an understanding of what was decided in *Hadley v Baxendale*.

Typical Wordings: 2 *Entertain v Sony*

“10.3 Neither party shall be liable under this Agreement in connection with the supply of or failure to supply the Logistics Services for any indirect or consequential loss or damage including (to the extent only that such are indirect or consequential loss or damage only) but not limited to loss of profits, loss of sales, loss of revenue, damage to reputation, loss or waste of management or staff time or interruption of business.”^[L]_[SEP]

2 Entertain Video Ltd v Sony DADC Europe Ltd [2020] EWHC 972 (TCC), 190 Con. L.R. 145

Typical Wordings: *Deepak*

Article 6.8 : "... and in no event shall DAVY by reason of its performance or obligation under this CONTRACT be liable ... for loss [of] anticipated profits, catalyst, raw material and products or for indirect or consequential damages."

Deepak Fertilisers Ltd v ICI Chemicals and Polymers Ltd [1999] 1
LI.Rep. 387 (CA)

Typical Wordings: *Transocean*

Clause 20:^[L]_[SEP]"(i) any indirect or consequential loss or damages under English law, and/or^[L]_[SEP](ii) to the extent not covered by (i) above, loss or deferment of production, loss of product, loss of use ... loss of business and business interruption, loss of revenue ... loss of profit or anticipated profit ...^[L]_[SEP]... the COMPANY shall save, indemnify, defend and hold harmless the CONTRACTOR GROUP from the COMPANY GROUP'S own consequential loss and the CONTRACTOR shall save, indemnify, defend and hold harmless the COMPANY GROUP from the CONTRACTOR GROUP'S own consequential loss..."

Transocean Drilling UK Limited v Providence Resources plc [2016] BLR 360

Typical Wordings: *Star Polaris*

Article IX, paragraph 4(a):^[L]^[SEP]"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".

Star Polaris LLC v HHIC-PHIL Inc [2017] 1 Lloyd's Rep. 203

Contractual Interpretation

- *Arnold v Britton* [2015] AC 1619 and *Wood v Capita Insurance Services Ltd* [2017] 2 WLR 1095
- Lord Neuberger in *Arnold* (at 1627-1628; esp para. 15) :

“15. ...meaning has to be assessed in the light of:

(i) the natural and ordinary meaning of the clause,

(ii) any other relevant provisions of the lease,

(iii) the overall purpose of the clause and the lease,

(iv) the facts and circumstances known or assumed by the parties at the time that the document was executed, and

(v) commercial common sense, but

(vi) disregarding subjective evidence of any party's intentions.”

The Orthodox Cases

- *Saint Line v Richardsons Westgarth & Co Ltd* [1940] 2 KB 99
- *Croudace Construction Ltd v Cawoods Concrete Products Ltd* (1978)
8 BLR 20
- *British Sugar plc v NEI Power Projects Ltd* (1997) 87 BLR 42 (CA)
- *Deepak Fertilisers Ltd v ICI Chemicals and Polymers Ltd* [1999] 1
Lloyd's Rep 387
- *Hotel Services v Hilton International* [2000] BLR 235

The “Principle”

Saint Line Ltd v Richardsons, Westgarth and Co Ltd [1940] 2 KB 99,
Atkinson J stated:

"What does one mean by "direct damage"? Direct damage is that which flows naturally from the breach without other intervening cause and independently of special circumstances, while indirect damage does not so flow. The breach certainly has brought it about, but only because of some supervening event or some special circumstances ...

In Millar's Machinery ... the Court there took it for granted that the word "consequential" meant "merely consequential" and referred to something which was not the direct and natural result of the breach. In my judgment the words "indirect or consequential" do not exclude liability for damages which are the natural result of the breaches complained of... If one takes loss of profit, it is quite clear that such a claim may very well arise directly and naturally from the breach based on delay."

The Sticking Point

"... Both the Millar case and the Croudace case were construing the word "consequential" in a very similar context to that which appears in this case. With Court of Appeal authority construing a phrase in a very similar context, and another Court of Appeal saying that the view previously expressed is binding in yet another similar context, it would take some radical difference in language or a radical difference in context to persuade yet a further Court of Appeal not to construe the phrase the same way ... [L] [SEP]"

Second, in any event once a phrase has been authoritatively construed by a court in a very similar context to that which exists in the case in point, it seems to me that a reasonable businessman must more naturally be taken to be 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."

- Waller LJ in *British Sugar* (emphasis added)

Doubts

- *Caledonia North Sea Ltd v London Bridge Engineering Ltd* [2002] 1 Lloyd's Rep. 553 at paras. 99-100, Lord Hoffmann.
- *McGregor on Damages* (20th ed.) 3-012 – 3-016
- *Lewison* in the Supplement to the Sixth Edition.
- *Transocean Drilling UK Ltd v Providence Resources plc* [2016] BLR 360 para. 15, Moore-Bick LJ.
- *Star Polaris LLC v HHIC-Phil Inc* [2017] 1 Lloyd's Rep. 203

Why it's a Fallacy

- An outmoded and overly mechanistic approach to the principle in *Hadley v Baxendale*
- Alderson B stated at pp 354–356.

“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.”

Why it's a Fallacy

- *Transfield Shipping Inc v Mercator Shipping Inc (The Achilleas)* [2009] 1 A.C. 61; Lord Walker paras. 66-67 (and Lord Hoffmann paras. 11-23), quoting Goff J in *Heron II*:
- *“The general result of the two cases is that the principle in Hadley v Baxendale is now no longer stated in terms of two rules, but rather in terms of a single principle ... This approach accords very much to what actually happens in practice; the courts have not been over-ready to pigeon-hole the cases under one or other of the so-called rules in Hadley v Baxendale , but rather to decide each case on the basis of the relevant knowledge of the defendant.”*
- There is one principle, not two limbs. Not about categorisation, but knowledge.

Contractual Intentions

- *Transocean*, Moore-Bick LJ (at para. 23):

“the court's task is not to re-shape the contract but to ascertain the parties' intention, giving the words they have used their ordinary and natural meaning.”

- *Star Polaris*, Sir Jeremy Cooke (at para. 39):

“the phrase ‘consequential or special losses, damages or expenses’ does not mean such losses, damages or expenses as fall within the second limb of Hadley v Baxendale but does have the wider meaning of financial losses caused by guaranteed defects, above and beyond the cost of replacement and repair of physical damage”

2 Entertain v Sony: Radical

- Give and take:

“The starting point is to consider the natural and ordinary meaning of the clause.” (para. 222)

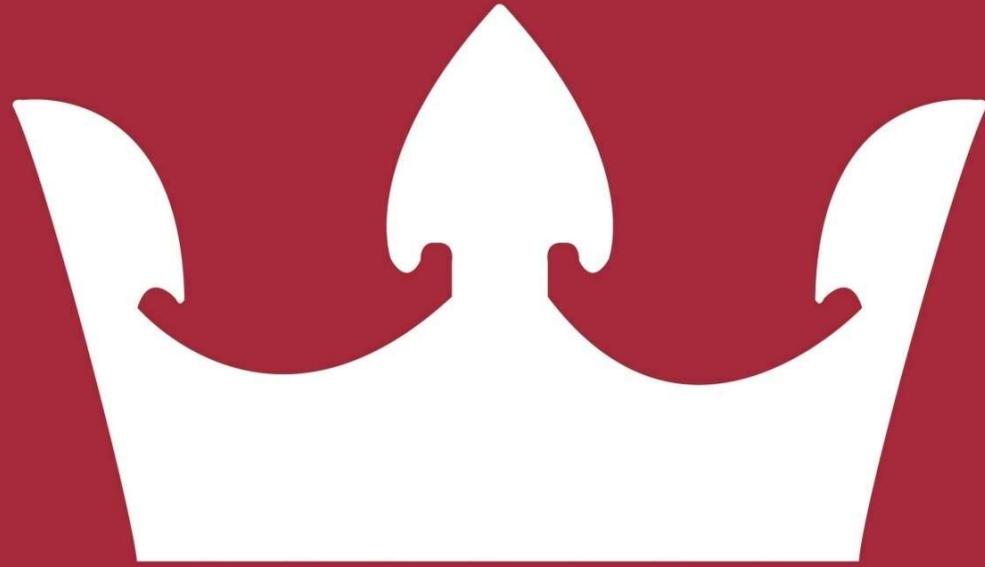
“...any general understanding of the meaning of "indirect or consequential loss" [from case law] must not override the true construction of that clause when read in context against the other provisions in the Logistics Contract and the factual matrix.” (para. 238)

2 Entertain v Sony: Orthodox

- *“The exclusion covers liability for all contractual obligations in connection with performance of the Logistics Services. The exclusion is “for any indirect or consequential loss or damage”. The direct and natural result of the fire was the destruction of the goods and the warehouse, causing lost profits and business interruption losses to the claimants. Therefore, the claims in this case do not appear to fall within the scope of the exclusion.” (para. 222)*
- *“The effect of the words in parentheses is to negate the illustration intended by the words of inclusion. The only way in which these words can be given effect is to treat the reference to “loss of profits ...” and following categories of loss as losses that might or might not fall within the exclusion. As such, they are of no assistance in determining whether the losses claimed in this case fall within or without the exclusion.” (para. 223)*

The Future

- Likely the Court will feel less bound by the orthodox position
- More likely to give the parties' intentions, by their words in context, more consideration.
- More likely to look at the ordinary meaning of the words "consequential" or "indirect".
- Still sensible to bear in mind the risk of the case law when drafting.
- Even attempts to capture all eventualities might fall foul of the orthodoxy, as in *Sony*.



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