

All Damage Is In A Sense Consequential – So What In Law Are Consequential Losses?

Written by International Construction Team

Sub-Clause 17.6 of FIDIC's Red, Yellow and Silver Book is an exemption clause and provides in the opening paragraph that:

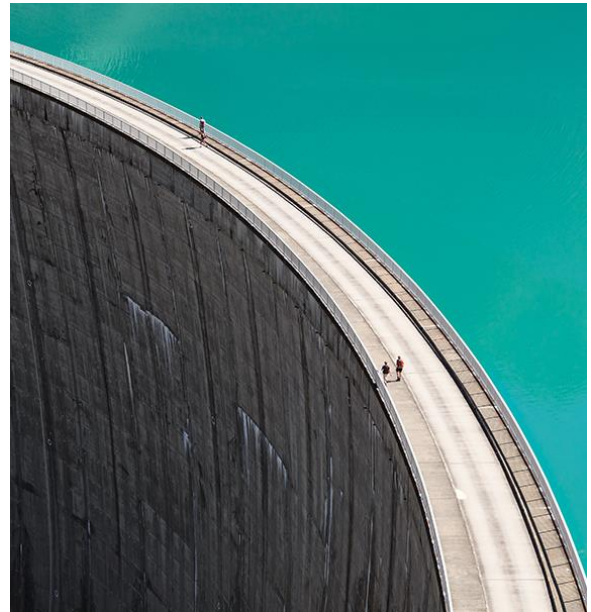
"Neither Party shall be liable to the other Party for loss of use of any Works, loss of profit, loss of any contract or for any indirect or consequential loss or damage which may be suffered by the other Party in connection with the Contract..."

The phrase 'indirect or consequential loss or damage' has been examined by the English courts on numerous occasions. Historically the words 'consequential loss' were held to be synonymous with 'indirect loss'. However, a recent case questions whether this will be correct in all cases. It is also of note that the courts in different countries interpret the words 'consequential loss' differently to the way that the English courts interpret them.

Direct and Indirect Losses

In the seminal case of *Hadley v Baxendale* (1854) 9 Exch 341, 354 the English House of Lords stated:

"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 a 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, [The first limb] 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. [The second limb]"



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Direct losses are therefore those losses which flow naturally from the breach of contract. Indirect losses are those which 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. The distinction is easy to demonstrate. In *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd* [1949] 2 KB 528 it was held that the direct losses arising from a five month delay to provide an industrial washing machine would include lost profits from contracts which the claimant would normally carry out as part of its business whereas the loss of a special contract for the army was an indirect loss, the losses of which would only be recoverable if the defendant was aware of the existence of that contract at the time it entered into the contract with the claimant.

Indirect and Consequential Losses – The Traditional Approach

It has been stated that the phrase 'consequential loss' is not very illuminating, as all damage is in a sense consequential: per Atkinson J., *Saint Line Ltd v Richardson Westgarth & Co* [1940] 2 KB 99. Atkinson J. proceeded to state that an exemption clause referring to 'consequential loss' does not exclude direct losses; i.e. losses that flow naturally from the



breach¹. In the case of *British Sugar plc v Projects Ltd (1997) 87 BLR 42* it was argued that loss of profits were consequential losses.

The argument was advanced that to a reasonable businessman 'consequential losses' would include loss of profits. However, the Court of Appeal held that it was bound by authority and that loss of profits would usually be a direct loss and therefore not covered by the phrase 'consequential loss.' The Court of Appeal confirmed this in *Hotel Services Ltd v Hilton International (Hotels) Ltd [1998] EWCA Civ 1822 [8]* and stated that loss of profits were a natural consequence of the faulty equipment "*and therefore untouched by the exemption clause which (since all recoverable loss is literally consequential) plainly uses 'consequential' as a synonym for 'indirect'.*" Therefore, the traditional approach of the English courts has been to treat the words 'consequential loss' as being synonymous with 'indirect loss'.

Indirect and Consequential Losses – A New Approach?

The traditional approach was questioned in *Caledonia North Sea v British Telecommunication [2002] BLR 139 (HL)* and *Transocean Drilling v Providence Resources [2016] BLR 360 (CA)*. Both Lord Hoffman and Moore-Bick LJ considered whether the traditional line of cases, which had considered the words 'consequential loss' to be synonymous with 'indirect loss,' would be decided in the same way now.

In the recent case of *The Star Polaris [2016] EWHC 2941* the High Court had to consider an arbitrator's award which concluded that the words 'consequential or special losses' had a wider meaning than simply being limited to indirect losses (i.e. the second limb of *Hadley v Baxendale*). The High Court considered two recent Supreme Court cases on contractual interpretation - *Chartbrook v Persimmon Homes [2009] 1 AC 1101* and *Arnold v Britton [2015] AC 1619*. The High Court found that the exemption clause had to be construed having regard to the parties' intentions and against the relevant factual matrix. The court concluded that despite the line of authorities supporting the traditional approach "*the well-recognised meaning was not the intended meaning of*

the parties and that the line of authorities is therefore nothing to the point." The court therefore held:

"...as in the judgment of the Arbitrators, '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 a wider meaning of financial losses caused by guaranteed defects, above and beyond the cost of replacement and repair of physical damage."

The recent Supreme Court case of *Wood v Capita Insurance Services [2017] UKSC 24* also supports the view that when construing a contract the court may find on the facts that the parties' objective intentions were to give the words 'consequential loss' a broader meaning than just simply 'indirect loss'. The court, when construing a contract, has to look at the contract as a whole. The court must analyse both the language of the contract (a textual analysis) and the factual background and implications of the rival constructions (a contextual analysis). As Lord Hodge stated:

"The extent to which [textualism or contextualism] will assist the court in its task will vary according to the circumstances of the particular agreement or agreements. Some agreements may be successfully interpreted principally by textual analysis, for example because of their sophistication and complexity and because they have been negotiated and prepared with the assistance of skilled professionals. The correct interpretation of other contracts may be achieved by a greater emphasis on the factual matrix, for example because of their informality, brevity or the absence of skilled professional assistance. But negotiators of complex formal contracts may often not achieve a logical and coherent text

¹ See also *Croudace Construction Ltd v Cawoods Concrete Products Ltd (1978) 87 BLR 20*.



because of, for example, the conflicting aims of the parties, failures of communication, differing drafting practices, or deadlines which require the parties to compromise in order to reach agreement. There may often therefore be provisions in a detailed professionally drawn contract which lack clarity and the lawyer or judge in interpreting such provisions may be particularly helped by considering the factual matrix and the purpose of similar provisions in contracts of the same type. ..."

Other Jurisdiction

In Australia, there has been a significant departure from the approach taken by the English courts to the interpretation of the words 'consequential loss'. In *Environmental Systems Pty Ltd v Peerless Holdings Pty Ltd [2008] VSCA 26* the court stated that consequential loss would include any loss which did not "*naturally and ordinarily*" flow from the breach of contract and therefore would include loss of profits. This approach has been adopted and extended by other courts in Australia: see *Alstom Ltd v Yokogawa Australia Pty Ltd (No 7) [2012] SASC 49*. In the Alstom case it was held that an exemption clause prohibiting claims for consequential losses would include all types of loss except for claims for liquidated damages and damages associated with performance guarantee payments, which were expressly provided for in separate clauses of the contract.

The issue of what is covered by the phrase 'consequential loss' was recently considered again in *Regional Power Corporation v Pacific Hydro Group Two Pty Ltd [2013] WASC*. In this case the court held that the Hadley v Baxendale and the Peerless approach were both wrong. The court stated that the words in the exclusion clause had to be given their "*natural and ordinary meaning, read in light of the contract as a whole.*" In this case the court found that the losses which had been suffered were direct losses and not consequential losses and therefore were not covered by the exclusion clause.

The approach taken by some American courts also differs from the English approach. In *Jay Jala v DDG Construction [2016] (US District Court of Pennsylvania)* the court followed a similar approach to that taken in the Peerless case. In this case the court stated:

"Direct damages are the costs of getting what the contracting party was supposed to give – the costs of replacing [the Defendants] performance. Other costs that may not have been incurred [but for the breach of contract], but that are not part of what [the Claimant] was supposed to get from [the Defendant], are consequential or a secondary consequence."

Loss of profit or loss of income would therefore be classed as a consequential loss applying the principles in the Jay Jala case. In other countries it has been suggested that indirect losses are economic losses (i.e. non-physical) that are a consequence of a defect.²

Summary

The phrase 'consequential loss' is not helpful because all losses are to some extent consequential upon a breach. Given that the courts have in some countries interpreted the words 'consequential loss' so as to exclude direct losses it is important to be clear how the substantive law will construe the meaning of this phrase. Employers, in particular, should be concerned about this phrase because in many cases, for example where plant or infrastructure is being built, their losses will primarily be economic losses arising from the non-operability of the plant or the infrastructure.

² See www.ibanet.org/Forum - Thread: FIDIC 17.6 Limitation of Liability.

