CONSEQUENTIAL LOSS—WHAT DOES IT MEAN?

Ren Niemann, Senior Associate

Rima Hor, Law Graduate

Allens Arthur Robinson, Sydney

Greater complexity in construction and infrastructure projects means risk–averse contractors and consultants typically look for contractual protection from liability for consequential loss suffered by the other party or third parties. Despite the frequency that the term 'consequential loss' is used, it is not clear to many what it means and what types of loss it comprises. This article explores some of the drafting issues that parties need to be aware of when contemplating clauses excluding liability for consequential loss.

HOW DOES IT AFFECT YOU?

• In light of the Australian and English cases on what comprises 'consequential loss', considerable care is required in negotiating and drafting clauses that exclude or limit liability for consequential loss.

• It is important to be as specific as possible about the type of loss that will not be recoverable.

• It is important to understand how an exclusion clause interacts with the contractual insurance regime.

CURRENT LAW—RECOVERABILITY OF LOSS

It is well established in the United Kingdom and Australia that losses can be recovered under two limbs,[1] namely:

• the losses arise naturally, according to the usual course of things, as the result of the breach (first limb); or

• the losses were contemplated by the parties, at the time that the parties made the contract, as being the probable result of the breach (second limb).

Cases from the United Kingdom indicate that consequential loss is to be equated with the second limb.[2] This has been confirmed in Australia in Frank Davies v Container Haulage Group (1989) 98 FCR 289, and more recently in Peerless Holdings Pty Ltd v Environmental Systems Pty Ltd [2006] VSC 194.

WHAT IS CONSEQUENTIAL LOSS?

Although clauses often contain expressions such as 'indirect, special or consequential loss or damage', judicial authority would indicate that the difference between these terms is more semantic than real: Hotel Services Limited v Hilton International Hotels (UK) Limited [2000] BLR 235. In other words, in practice, consequential loss may be used interchangeably with indirect loss, or more broadly, it is loss that is a step removed from the transaction and its immediate effect[3] or one step removed from those which flowed naturally from a breach of contract.[4]

However, an overview of cases in this area reveals that the types of loss encompassed within 'consequential loss' may vary according to the nature and subject matter of the contract. For example, it is sometimes assumed that loss of revenue, loss of profit or loss of anticipated profit will be considered indirect or consequential loss. However, a number of recent cases have held that these losses may be classified as a direct loss, and therefore recoverable despite clauses excluding liability for 'consequential loss'.[5]

PRACTICAL ISSUES FOR CONSIDERATION

Given the need for certainty and clarity in drafting exclusion clauses, the following practical issues need to be carefully considered.

• If a party wishes to be certain of what will be excluded, rather than merely referring to 'consequential loss', it may be necessary to specifically identify the types of loss which may not be

recoverable, such as loss of profit, loss of production, loss of revenue or loss of use.

• If there is a list of specific types of losses in addition to a generic reference to 'consequential loss', it is important to ensure that they are not listed in such a way as to be qualified by the generic reference. For example, in Pegler Ltd v Wang (UK) Ltd (No 1) [2000] BLR 218, it was held that the phrase 'any indirect, special or consequential loss, however arising (including but not limited to loss of anticipated profits or data)' still allowed a party to recover loss of profits that were direct and not consequential.

• If a party wishes to ensure that other parties (eg its agents, contractors and related bodies corporate) can avail themselves of the benefit of an exclusion clause, clear wording will be required. However, as those parties are not a party to the contract, the contract will need to include a mechanism to address privity of contract issues.

• It will also need to be considered whether there should be carve–outs from an exclusion for consequential loss; that is liability for consequential loss that will not be excluded or limited. Such carve–outs may include:

  • liability for third party liability claims;

  • liability for amounts the subject of insurance proceeds or amounts recoverable or indemnified under insurance;

  • liability for criminal acts or for fraud; and

  • liability for 'wilful default' and 'gross negligence' (although as the law does not recognise these concepts, they will need to be clearly defined).

• Additionally, if liquidated damages are payable (eg for delay or failure of performance), then it should be made clear that the exclusion of consequential loss does not affect the recoverability of those liquidated damages. This is particularly important where such liquidated damages have been calculated based on losses that may be consequential in nature.

• Finally, it is necessary to consider how the exclusion clause interplays with the insurance regime. In effect, the party accepting the exclusion of consequential loss liability is giving a release to the other party who has the benefit of the exclusion. This may affect the first party's rights to be indemnified under insurance policies (eg ISR, contract works or public liability). Accordingly, insurance advice should be sought to ascertain the insurer's position on such clauses and the impact it will have under the relevant policy.

SUMMARY

Introducing any exclusions of liability for consequential loss into a contract is legally complex and requires careful consideration of the issues. Without understanding how the law construes this term 'consequential loss', parties may find that the subsequent interpretation of the exclusion clause is at odds with the intention of the parties (or at least the party requiring the clause). If there is any ambiguity in the clause, this may be construed against the party requiring the exclusion. Accordingly, when drafting such clauses, parties should use clear language in articulating the types of loss that will not be recoverable.

REFERENCES

1. See Hadley v Baxendale (1854) 9 Ex 341

2. Croudace v Cawoods [1978] 8 BLR 20; BHP Petroleum Ltd v British Steel PLC [1999] 2 Lloyd's LR 583

3. GEC Alsthom Australia Ltd v City of Sunshine (Federal Court, Ryan J, 20 February 1996, unreported)

4. Peerless Holdings Pty Ltd v Environmental Systems Pty Ltd [2006] VSC 194

5. Deepak Fertilisers and Petrochemical Corporation v Davy McKee (London) Ltd and ICI Chemicals & Polymers Ltd [1999] Lloyd's Rep 387; GEC Alsthom Australia Ltd v City of Sunshine (Federal Court, Ryan J, 20 February 1996, unreported)

Ren Niemann and Rima Hor's article was previously published in Allens Arthur Robinson's Focus Construction—February 2007. Reprinted with permission.
