

Indirect and Consequential Loss

Joe Colgan,
EC Harris

Introduction

It is common practice in international standard form EPC contracts (such as ENAA and FIDIC) to refer to both “*indirect*” and “*consequential*” loss or damage in exclusion of liability clauses.

For example, Clause 17.6 of the FIDIC Silver Book provides:

“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, other than under...” (our emphasis)

This article explains why there is no legal difference between the words “*indirect*” and “*consequential*” in exclusion of liability clauses. It also explains how parties should interpret these words in commercial negotiations.

Legal Analysis

In *Croudace v Cawoods*¹, the English Court of Appeal stated that:

“The word “consequential” does not cover any loss which directly and naturally results in the ordinary course of events...”

Croudace followed the Court of Appeal decision in *Millars Machine Co Ltd v David Way & Son*². In *Millars*, Maugham J stated:

“On the question of damages, the word “consequential” had come to mean “not directly”, and the damages recovered by the defendant on the counterclaim arose directly from the plaintiff’s breach of contract...”

In *Millars*, Lord Justice Roche stated:

“That the damages recovered by the defendants on the counterclaim were not merely “consequential”, but resulted directly and naturally from the plaintiff’s breach of contract.”

Croudace has been followed recently by the Court of Appeal in *Deepak Fertilisers and Petrochemical Corporation v Davy McKee (London) Ltd* and *ICI Chemicals & Polymers Ltd*³. This approach was also adopted in a more recent decision of the Court of Appeal in *Hotel Services Limited v Hilton International Hotels (UK) Limited*⁴. In this case it was held that an exclusion clause which excluded “*any indirect or consequential loss, damages or liability*” clearly used “*consequential*” as a synonym for “*indirect*” (at paragraphs 8 and 16).

On the basis of these Court of Appeal decisions, it is unlikely there is any distinction between the words “*indirect*” and “*consequential*” in the context of an exclusion of liability clause. This view is further supported by the American construction law text *Proving and Pricing Construction Claims* (1990). At page 401-2, the authors distinguish between “*direct damages*” and “*consequential damages*”.

The scope of “indirect or consequential” loss or damage

The well known case of *Hadley v Baxendale*⁵ provides that where a party to a contract is in breach, the damages which the other party is entitled to falls under two limbs, namely, damages such as may fairly and reasonably be considered:

- to arise naturally (i.e., according to the usual course of things) from such a breach of contract (first limb); or
- to be in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of contract (second limb).

In the context of contractual exclusion of liability clauses for indirect or consequential loss or damage, both *Croudace and Millars* support the view that the term “*consequential*” is confined to the second limb of the rule in *Hadley v Baxendale*. On this view, the term “*indirect or consequential*” loss or damage would not include any loss which arises naturally upon the breach, but would include loss or damage which was in the contemplation of both parties, at the time the contract was made, as the probable result of its breach.

Accordingly, while the construction of each exclusion clause will depend on its own words and context, generally indirect or consequential loss and damage is likely to be loss or damage which falls within the second limb of *Hadley v Baxendale*. It is loss which is in some way less direct or more remote than loss or damage which remains recoverable under the first limb.

In practice, however, it is often very difficult to determine whether a loss falls within the first or second limb of *Hadley v Baxendale*.

It is important to understand that claims for loss of profit, while commonly thought to fall within the category of indirect or consequential loss (ie the second limb of *Hadley v Baxendale*), will often fall within the first limb (namely, loss which is a direct and natural consequence of the breach). The recent cases of *Hotel Services Limited v Hilton International Hotels (UK) Limited* and *Deepak Fertilisers v Davy McKee* are clear examples of this position.

In *Deepak*, loss of profits and wasted overheads incurred during the reconstruction of a plant were held by the Court of Appeal to be direct rather than indirect or consequential damages.

In the case of *Saint Line v Richardsons, Westgarth*⁶, the court held that a loss of profit claimed by the owners of a vessel was direct and immediate, and not “indirect or consequential” and was recoverable as falling outside the relevant

exclusion clause.

Given the above cases, parties must ensure that an exclusion of liability clause is carefully drafted and expressly excludes liability for the particular category of loss, for example, loss of use, loss of production or loss of profit as they may be construed as direct loss if not specified.

Conclusion

Although there is no legal distinction between the words “*indirect*” and “*consequential*” in exclusion of liability clauses, both terms are commonly used in this context. For example, the exclusion of liability clause in ENAA 1996 (GC 30.2) refers to “*any indirect, special or consequential loss or damage*”. Similarly, the exclusion of liability clause in the FIDIC Silver Book (Sub Clause 17.6) refers to “*indirect or consequential loss or damage*”.

For the purposes of commercial negotiations, parties should interpret the term “*indirect or consequential loss or damage*” as loss or damage falling within the second limb of the rule in *Hadley v Baxendale*. That is loss or damage which does not arise naturally in the usual course of things from the breach of contract, but loss which may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable results of the breach of it.