

# Exemption Clauses for Consequential Loss considered under English Law

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# 1 Introduction

This master thesis is going to deal with contractual clauses excluding liability for consequential or indirect loss in English law. In many industries it is common to have an exemption clause for consequential or indirect loss in the contract. In the maritime context, there are a few standard charter parties, for example SUPPLYTIME 1989 and 2005, which have an exemption clause for consequential loss. The purpose of this thesis is to find out what consequential or indirect loss comprises and how effective exemption clauses are.

Claims for consequential loss under bills of lading do not form part of this work. This is because bills of lading are subject to mandatory legislation which would have been too extensive to examine and delimitate from the rest of the thesis.

Consequential or indirect loss is incurred following a breach of contract. Therefore, this thesis is going to commence with a brief introduction to remedies for breach of contract and calculation of damages in English law. Afterwards, the rules on remoteness of damage which have developed out of three major cases are going to be discussed. These rules on remoteness will be referred to throughout this thesis which is why they are of particular importance.

In chapter 3, case law and literature concerning the interpretation of exemption clauses is going to be analyzed. These cases concern contracts from a variety of industries, except for charter parties which are going to be discussed later in this work. From the cases it will become clear that there is neither a clear-cut definition of what consequential loss is nor a unanimous approach of interpretation of exemption clauses by the courts.

In chapter 4 the thesis will continue with a review of selected charter party cases in which rather remote consequential losses claimed by the charterers were awarded. These charter parties did not have an exemption clause. Rather, the purpose of this chapter is to illustrate what dimensions consequential losses can reach, how remote they can be and that there might be a need to have exemption clauses in charter parties, too.

Eventually, in chapter 5 exemption clauses in standard charter parties will be discussed along with a few judgments. In this analysis the findings of chapter 3.4 which concern the interpretation of exemption clauses in general contract law will be applied.

The final conclusion is going to summarize the findings on the interpretation of clauses exempting liability for consequential loss, provide guidance on what to keep in mind when drafting an exemption clause and, finally, suggest wordings for exemption clauses which meet the parties' intentions.

## **2 Remedies for Breach of Contract and Remoteness**

### **2.1 Introduction**

This work is going to analyze the definition of consequential loss and the interpretation of exemption clauses excluding contractual liability for consequential loss following a breach of contract. In order to bring consequential loss into context, this chapter is going to provide an overview of the remedies for breach of contract in common law. In particular, different types of loss, how they are calculated and when they are awarded will be briefly discussed. Eventually, this chapter is going to close with a thorough discussion of the issue of remoteness. Awarding of damages is subject to the rules on remoteness. Moreover, these rules have a considerable impact on the interpretation of exemption clauses. Therefore, the rules on remoteness and the associated cases will be referred to throughout this work.

### **2.2 Types of Loss and Calculation of Loss**

#### **2.2.1 Introduction**

In English law the aim of damages is to put the injured party into the same position as if it had not sustained the wrong. This principle generally applicable to contract and tort has

been first established by Lord Blackburn in *Livingstone v Rawyards Coal Co.*<sup>1, 2</sup> In particular, at 39, he defined the measure of damages to be:

[T]hat sum of money which will put the party who has been injured, or who has suffered, in the same position as he would have been in if he had not sustained the wrong for which he is now getting his compensation or reparation.

This principle has been further developed and refined and for contractual claims the measure of damages is that the injured party has to be placed, so far as money can do it, in the same position as it would have been in had the contract been performed.<sup>3</sup> This was established in *Robinson v Harman*<sup>4</sup> and reconfirmed in a number of decisions.<sup>5</sup> In tort, as opposed to contract, damages aim at putting the injured party into the position it had been in had the tort never been committed.

Thus, damages are of compensatory and not punitive nature. Consequently, an injured party can never receive more compensation than its actual loss suffered.<sup>6</sup>

There are various ways of calculating damages which will be briefly discussed in the following. They are applied dependent on the type of loss suffered and the surrounding circumstances. Furthermore, there are various ways of dividing damages for breach of contract into categories. The traditional way is to classify damages into three interests: Expectation, reliance and restitution. However, Grubb and Tettenborn<sup>7</sup> do not deem this division

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<sup>1</sup> (1880) 5 App. Cas. 25

<sup>2</sup> Joseph Chitty and H. G. Beale, *Chitty on Contracts* (30th edn, Sweet & Maxwell 2008) para 1-022

<sup>3</sup> Joseph Chitty and H. G. Beale, *Chitty on Contracts* (30th edn, Sweet & Maxwell 2008) para 1-023

<sup>4</sup> (1848) 1 Ex 850

<sup>5</sup> For example cases see footnotes 79 and 80 in Joseph Chitty and H. G. Beale, *Chitty on Contracts* (30th edn, Sweet & Maxwell 2008) para 1-023

<sup>6</sup> Jill Poole, *Textbook on Contract Law* (11th edn, Oxford University Press 2012) 324-325

<sup>7</sup> Andrew Grubb and Andrew Tettenborn (eds), *The Law of Damages* (LexisNexis UK 2003) paras 19.53 - 19.56

to be entirely satisfactory and divide damages into expectation, reliance and consequential loss. This division is adapted in this work, too.

### 2.2.2 Liquidated Damages

Liquidated damages can be awarded if there is a liquidated damages clause in the contract. The purpose of a liquidated damages clause is to make a realistic estimate of the loss that is going to be incurred in case of a certain breach of contract.<sup>8</sup> Additionally, it gives the parties a degree of certainty about what will happen if one party is in breach. It is important to distinguish liquidated damages clauses from penalty clauses which can be difficult at times. While liquidated damages should be a genuine estimate of the likely losses, penalties aim at deterring the parties from breaking the contract and punishing them in case of breach. Until the Court of Appeal's judgment in *Jobson v Johnson*<sup>9</sup> it was the general understanding that penalty clauses are wholly unenforceable. This idea had already been existent when it was first laid down in *Astley v Weldon*<sup>10</sup> where it was stated that even in common law, as opposed to equity, a penalty clause could not be enforced but only the damages which could be proven to be actually incurred could be recovered.<sup>11</sup> In *Jobson v Johnson* it was held that penalty clauses are not unenforceable as a matter of fact. Rather, they are only enforceable up to the loss that was actually incurred.<sup>12</sup>

### 2.2.3 Cost of Cure and Expectation Loss

One measure of calculating damages is that the injured party gets awarded so-called cost of cure. As the name suggests, this is the amount necessary to fulfill the contract, so to receive the performance contracted for. There are limits to the cost of cure, for example, awarding the cost of cure must not lead to a wholly unreasonable result and it must be certain that the

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<sup>8</sup> *Dunlop Pneumatic Tyre Co. Ltd. v New Garage and Motor Co. Ltd.* [1915] AC 79

<sup>9</sup> [1989] 1 WLR 1026

<sup>10</sup> (1801) 2 B. & P. 346

<sup>11</sup> For more information on the history of liquidated damages and penalties, see Harvey McGregor, *McGregor on Damages* (18th edn, Sweet & Maxwell 2009) ch 13, paras 13-001 - 13-006

<sup>12</sup> Jill Poole, *Textbook on Contract Law* (11th edn, Oxford University Press 2012) 371-373

injured party will actually use the award to obtain what was contracted for. These limits will be discussed further in the next chapter.

If awarding cost of cure is not appropriate, the injured party may get compensated for its expectation loss. Expectation loss is compensation for benefits the injured party gets deprived of due to the breach of contract.<sup>13</sup> Usually, this is calculated with the help of the market price of the good or service that was contracted for.<sup>14</sup>

Which of these two methods of assessing damages is used depends on which one is more appropriate. However, there may be cases where neither method is appropriate.

#### 2.2.4 Limitations to Cost of Cure and Expectation Loss

There can be situations in which neither cost of cure nor expectation loss are appropriate measures of calculating damages. This may be because it is unreasonable and out of proportion to award damages on this basis. Additionally, it can be questionable whether the claimant will use the award to actually cure the damage.<sup>15</sup> If it does not it would be unjustly enriched by the damages award and this would be at odds with the general principle that damages are to put the injured party into the position it had been in had the contract been properly performed. Expectation loss and cost of cure may be inappropriate in cases where the loss is difficult to quantify because it is of personal, subjective nature. The leading cases with regards to this issue are *Ruxley Electronics v Forsyth*<sup>16</sup> and *Farley v Skinner (No. 2)*<sup>17</sup>.

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<sup>13</sup> On the distinction between expectation loss and loss of profit, see Andrew Grubb and Andrew Tettenborn (eds), *The Law of Damages* (LexisNexis UK 2003) para 19.59

<sup>14</sup> Neil Andrews and others, *Contractual Duties: Performance, Breach, Termination and Remedies* (Sweet & Maxwell 2011) para 21-040

<sup>15</sup> Jill Poole, *Textbook on Contract Law* (11th edn, Oxford University Press 2012) 332-333

<sup>16</sup> [1996] 1 AC 344

<sup>17</sup> [2001] UKHL 49, [2002] 2 AC 732

In *Ruxley* the defendant employed the claimant to build a pool of a certain depth in his garden. Eventually, the pool was 1.5 feet less deep than contracted for but the court did not find that the defendant suffered any loss from it since all the activities he wanted the pool for could have been carried out in the pool that was built. The only way of rectifying the defect would have been to build a new pool at the price of GBP 21,560. The High Court deemed this to be out of proportion and awarded GBP 2,500 for loss of amenity. The Court of Appeal, however, found in favor of the defendant and awarded GBP 21,560 in damages. The House of Lords restored the original award for lost amenity because the Lords deemed a cost of cure award to be unreasonable. A further reason for the judgment was that it was questionable whether the defendant would actually use the damages award to demolish the pool and build a new one.

In *Farley v Skinner* neither cost of cure nor expectation loss were deemed appropriate measures to calculate damages. The claimant intended to buy a house near Gatwick airport and employed a surveyor in order to find out whether there would be a lot of noise disturbance due to the nearby airport. The surveyor confirmed that there was little disturbance and the claimant went ahead to buy the house. It turned out that there was a lot of aircraft traffic close to the house because this was the area the airplanes waited for clearance to land. Since the major purpose of the survey was to find out about the level of noise and thereby ensuring peace of mind to the claimant there was a breach of contract. The claimant was awarded GBP 10,000 in distress damages. This judgment was successfully appealed but eventually restored by the House of Lords.

In cases in which the claimant may be legally right but has not suffered any loss by the breach of contract the courts will award nominal damages<sup>18</sup>. Nominal damages have a

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<sup>18</sup> For more information on nominal damages, see Andrew Grubb and Andrew Tettenborn (eds), *The Law of Damages* (LexisNexis UK 2003) paras 2.05 - 2.19

purely symbolic character. There is no fixed figure for nominal damages but they have been in the range between GBP 5 and 10.<sup>19</sup>

A further limit is that expectation losses may not be too speculative. An example is the Australian case *McRae v Commonwealth Disposals Commission*<sup>20</sup> which may be contrasted with *Chaplin v Hicks*<sup>21</sup>. In *McRae* the losses claimed were too speculative and therefore only wasted expenditure was awarded. The defendant Commission had invited tenders for the purchase of a wrecked oil tanker which was supposed to be lying on a reef. The vessel was said to contain oil. The claimant's tender was accepted and expenses were incurred by the claimant in preparing the salvage operation. Eventually, there was no oil tanker at the location and the defendants sought to recover their expenses incurred as well as lost profits from the oil tanker and the oil which they did not receive. The claimants were awarded the purchase price as well as the wasted expenses for the salvage operation but were unsuccessful with their claim for lost profits since the Commission had never promised to deliver a ship of a certain size nor that it would contain oil.

In *Chaplin*, on the other hand, the expectation losses were quantifiable and therefore awarded, although the quantification was not easily done. The claimant, a theatrical manager, and the defendant had an agreement according to which the defendant would be given the chance to attend an interview. Following the interview, twelve out of fifty interviewees would be employed. Eventually, in breach of contract, the defendant was not given a reasonable opportunity to attend the interview. The defendant succeeded in her claim for expectation loss, although it was not certain that she would have been employed had she attended the interview. Nevertheless, the chances of being chosen for employment were quantifiable and not deemed to be too speculative like in *McRae*.

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<sup>19</sup> Andrew Grubb and Andrew Tettenborn (eds), *The Law of Damages* (LexisNexis UK 2003) paras 2.05 - 2.06

<sup>20</sup> (1951) 84 CLR 377

<sup>21</sup> [1911] 2 KB 786

### 2.2.5 Wasted Expenditure/Reliance Loss

Wasted expenditure which is also called reliance loss is a different form of damages award. This is because it aims at putting the injured party into the position it had been in had the contract never been made as opposed to had the contract been properly performed.<sup>22</sup> Damages can incur if the injured party acted in a particular way in reliance on the contract being performed by the other party. Furthermore, the injured party can claim that it would have acted differently had it known that the other party would not perform.<sup>23</sup> A limitation to claims for wasted expenditure was established in *Omak Maritime Ltd. v Mamola Challenger Shipping Co.*<sup>24</sup> In this case Teare J stated that a claim for reliance loss cannot succeed if it puts the claimant into a better position than it would have been in had the contract been performed properly. The case concerned a time charter party for a supply vessel. According to the charter party terms the owners had to make expensive modifications to the vessel prior to delivery. Eventually, the charterers repudiated the contract and the owners terminated the charter party for repudiatory breach. The owners sought to recover the expenses incurred for the modification of the vessel, in spite of the fact that the hire rates increased after the repudiation and the owners could earn much more than with the repudiated charter. The owners succeeded in arbitration but the court on appeal held that the owners suffered no net loss due to the breach of contract and therefore they could not recover the modification costs because this would have put them into a better position than they would have been in had the contract been properly performed.

### 2.2.6 Consequential Loss

Losses incurred following a breach of contract can be of two different types: They can either be evident immediately, or they can be of consequential nature and become evident only at second sight. If a product is delivered in damaged condition the loss is evident immediately: It is the difference in value between the market price of the product and the val-

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<sup>22</sup> Jill Poole, *Textbook on Contract Law* (11th edn, Oxford University Press 2012) 338

<sup>23</sup> Andrew Grubb and Andrew Tettenborn (eds), *The Law of Damages* (LexisNexis UK 2003) para 19.61

<sup>24</sup> [2010] EWHC 2026 (Comm), [2011] Bus LR 212



ue in damaged condition. Consequential damages, on the other hand, can be lost profits resulting from, for example, loss of lucrative markets, personal injury, liabilities to third parties or damage to property.<sup>25</sup>

A very good example that illustrates the difference between these two types of losses is *H. Parsons (Livestock) Ltd. v Uttley Ingham & Co. Ltd.*<sup>26</sup>. In this case an animal feed hopper was sold to a farmer. The sellers installed the hopper but did not ensure that the ventilation was working properly. It turned out that the ventilation was defective and as a consequence thereof the animal feed became moldy. The animals ate the moldy feed and got sick. Eventually, 254 pigs died. The loss that is evident immediately is the damaged ventilation. The consequential loss, on the other hand, is the dead animals. The question is whether compensation for the dead animals can be successfully claimed. Therefore, the remoteness of the losses must be determined.

The Court of Appeal applied the remoteness test and found that the death of the pigs was not too remote to be recoverable. It found that illness to the pigs should have been in the reasonable contemplation of the parties as a consequence of the breach of contract to install a hopper with defective ventilation. Although the extent of the damage was not foreseeable the type of damage was and therefore the vendors were liable for the death of the pigs

The rules on remoteness that were applied, for instance, in *H. Parsons (Livestock) Ltd. v Uttley Ingham & Co. Ltd.* and many further cases discussed in this work will be presented in the following chapters.

## **2.3 Remoteness**

### **2.3.1 Introduction**

Claims for damages are subject to the rules of remoteness. This means that losses must not be too remote in order to be recoverable. The leading case with regards to remoteness is the

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<sup>25</sup> Andrew Grubb and Andrew Tettenborn (eds), *The Law of Damages* (LexisNexis UK 2003) para 19.74

<sup>26</sup> [1978] 1 QB 791

1854 decision in *Hadley v Baxendale*<sup>27</sup>. The rules on remoteness which were established in this case have been refined in a few subsequent cases, however, *Hadley v Baxendale* is still the leading case in the area of remoteness and of major importance nowadays. In the next chapter the rules on remoteness established in *Hadley v Baxendale* and their developments will be discussed. Additionally, these rules will be referred to throughout this work, in particular in the analysis of exemption clauses for consequential losses.

### 2.3.2 The Hadley v Baxendale Principle

In English law of contract the test with respect to remoteness of damage has been established as early as 1854 in the leading case *Hadley v Baxendale*<sup>28</sup>. In *Hadley v Baxendale* the plaintiffs who were the owners of a flour mill contracted with the defendants for the shipment of a broken crank shaft from Gloucester to Greenwich. The crank shaft was meant to serve as a model for another crank shaft which was to be newly built. The defendants were the carriers and due to negligence on the part of the defendants the crank shaft arrived in Greenwich with a delay of seven days. The plaintiffs claimed loss of profits for the time they could not run their mill due to the delayed delivery. The defendants claimed these losses to be too remote to be recoverable. The purpose of the shipment was to send the broken shaft to an engineer who was supposed to build a new one. The new shaft should have been shipped back to the mill. The defendant had not been informed that the plaintiff's business had come to a halt once the crank shaft broke down. So they could have assumed the plaintiffs to have a spare crank shaft which replaced the broken one while the new one was being built. The court decided in favor of the defendants and found the lost profits claimed to be too remote. Furthermore, the court laid down the following rules on remoteness which are still applied nowadays:

- a) Damages recoverable under a contract must arise either “naturally” from the breach of contract itself, ie from the usual course of things, or they must have been within

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<sup>27</sup> (1854) 9 Exch 341

<sup>28</sup> (1854) 9 Exch 341

the reasonable contemplation of both parties to be a probable result of the breach at the time the contract was concluded.

- b) “Abnormal” losses arising due to special circumstances (such as in the present case) can only be recoverable if the party in default had been aware of these special circumstances at the time of contract. Thus, such circumstances must have become part of their reasonable contemplation and consequently the party in default must have become aware of the additional risk it was taking.

This test is often called the “two limbs test”. This terminology is going to be used throughout this work.

### 2.3.3 Developments of the *Hadley* Principle

Following *Hadley v Baxendale* the remoteness test has been refined in a few cases. The most important cases are *Victoria Laundry (Windsor) Ltd. v Newman Industries Ltd.*<sup>29</sup> and the House of Lords’ decision in *Koufos v C. Czarnikow Ltd. (The Heron II)*<sup>30</sup>.

In *Victoria Laundry* the plaintiffs who ran a laundry and dyeing business wanted to extend their activities and bought a boiler from the defendants. The boiler got damaged before it could be delivered. Therefore, the delivery got delayed by five months. The defendants were aware that the plaintiffs intended to use the boiler upon delivery. The plaintiffs claimed damages for:

1. Lost profits which could have been earned with the boiler within the five months period of delay and
2. Lost profits on a few very lucrative dyeing contracts which the plaintiffs claimed they “could and would have accepted”.

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<sup>29</sup> [1949] 2 KB 528

<sup>30</sup> [1969] 1 AC 350

The court held, following the principles established in *Hadley v Baxendale*, that lost profit due to normal business activities was reasonably foreseeable. However, the defendants had no means of being aware of the new highly lucrative contracts and therefore the loss resulting from these contracts due to the breach could not have been within their reasonable contemplation at the time the contract was entered into. Owing to this, the part of the lost profit incurred due to the delay which followed from the highly lucrative contracts was deemed to be too remote to be recoverable.

In *Koufos v C. Czarnikow Ltd. (The Heron II)* the plaintiffs were sugar merchants who chartered a vessel from the defendant shipowners for the carriage of sugar from Constanza, Ukraine, to Basrah, Iraq. The shipowners deviated from the agreed route in breach of the charter party. As a consequence thereof, the vessel arrived at Basrah 11 days later than advised. The defendants knew that the plaintiffs were sugar traders and they were also aware that there was a sugar market in Basrah. However, they did not have any further information as to the intentions of the plaintiffs with regards to the shipment in question. It turned out that the plaintiffs had intended to sell the sugar on arrival in Basrah but due to market fluctuations the market price had dropped between the original ETA (estimated time of arrival) and the actual arrival day. The plaintiffs claimed the difference in market price from the defendants.

The court held that the plaintiffs were entitled to damages for lost profit since, although the defendants did not have actual knowledge of the plaintiffs' intentions, it was held not to be unlikely that the sugar should have been sold on arrival and that the sugar price was subject to fluctuation. The reasonable foreseeability test used in *Victoria Laundry* was deemed inapplicable as it was the test of remoteness applicable in tort but not in contract. The test of remoteness in contract is whether the loss is within the reasonable contemplation of the parties at the time the contract is entered into, as used in *Hadley v Baxendale*.

### 2.3.4 Transfield Shipping – A New Test of Remoteness?

A different approach to remoteness has been applied in the 2009 House of Lords decision *Transfield Shipping Inc. v Mercator Shipping Inc. (The Achilleas)*<sup>31</sup>. In this case the plaintiff owners claimed USD 1,364,584.17 from the defendant charterers who redelivered the vessel after a time charter that was entered into in 2003 with a delay of nine days. Due to the delay the plaintiffs had to renegotiate their subsequent charter and had to agree to a deduction of hire of USD 8,000 per day in order for the next charterers not to exercise their cancelling option. The plaintiffs therefore claimed USD 8,000 x 191 days, which was the duration of the follow-on charter. The Tribunal by majority decided in favor of the plaintiff owners. The dissenting arbitrator, however, found that only the difference in the market rate and charter rate in the nine days overrun period was recoverable. He argued that there was a general understanding in the shipping market that liability was limited to the difference between the market rate and charter rate for the period of wrongful delayed redelivery, thus the overrun period only.

Both the first instance court<sup>32</sup> and the Court of Appeal<sup>33</sup> dismissed the charterer's appeal and followed the Tribunal's majority decision. The House of Lords, however, ruled that only the lost profit suffered within the nine days of delayed redelivery was recoverable from the defendant charterers. This was the opinion of the dissenting arbitrator. Although the test of remoteness laid down in *Hadley v Baxendale* may have lead to a different result, ie that such a loss would have been within the reasonable contemplation of the parties at the time the contract was entered into, the judges nevertheless came to this result. This was, inter alia, because two judges (Lord Hoffmann and Lord Hope) applied a different test of remoteness than the classic test established in *Hadley v Baxendale*. This test is the "assumption of responsibility" test with the consequence that objectively the defendants could not have assumed responsibility for lost profit in a follow-up charter in case of late redeliv-

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<sup>31</sup> [2008] UKHL 48, [2009] 1 AC 61

<sup>32</sup> [2007] 1 Lloyd's Rep. 19

<sup>33</sup> [2007] 2 Lloyd's Rep. 555

ery, based on the market conditions. The Lords distinguished this test from the test in *Hadley v Baxendale* in so far as remoteness would not be determined based on normal and abnormal loss but on the question if the contract breaker ought to have accepted responsibility for a particular kind or type of loss. Moreover, Lord Hoffmann found that there was an understanding in the shipping industry that liability would be restricted to the duration of the overrun period.

Lord Roger found that neither party would reasonably have contemplated that a delayed redelivery of nine days would, in the ordinary course of things, cause the owners the type of loss<sup>34</sup> which they eventually incurred. He followed that the loss claimed by the owners was not normal loss but the product of extremely volatile market conditions which forced the owners to renegotiate the hire of their follow-on charter to the extent they had to. Furthermore, he argued that the charterers had no particular knowledge of the discount the owners granted to their charterers which is why the loss was too remote to be recoverable. Baroness Hale's analysis was in line with Lord Roger's.

Lord Walker did not exactly agree to Lord Hoffmann's and Lord Hope's assumption of responsibility approach. He argued that the parties had not contracted on the basis that the charterers would be faced with unlimited liability stemming from the follow-on charter, particularly because the charterers had neither knowledge of nor control over the terms of the follow-on charter.

The majority found that the charterers had assumed responsibility for the delay of nine days in redelivering the ship but they had not assumed responsibility for the duration of the en-

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<sup>34</sup> There is criticism that Lord Roger and Baroness Hale should have referred to the extent and not the type of loss not having been in the contemplation of the parties. See Guenter Treitel, *The Law of Contract* (13th edn, Sweet & Maxwell 2011) para 20-110

tire follow-on charter because this was a loss they could neither control nor quantify or predict.<sup>35</sup>

In subsequent cases, however, judges have been reluctant to consider the “assumption of responsibility” test as a new test and to apply it but rather stuck to the approach laid down in *Hadley v Baxendale*.<sup>36</sup>

For example, in *The Sylvia*<sup>37</sup> the facts were slightly different than in *The Achilleas*. Here it was the charterers who lost a sub-fixture due to breach of contract by the owners. The question was whether the limit of liability for late delivery was the overrun period, as the nine days period in *The Achilleas*. M/V *Sylvia* got detained by Port State Control because the owners were in breach of due diligence and maintenance obligations. The charterers had sub-chartered the vessel and owing to the delay caused by the detention the vessel missed the cancelling date. The sub-charterers then used their cancelling option. The substitute fixture was less profitable to the charterers than the cancelled one. Therefore, the charterers claimed their losses from the owners and the owners claimed that they were only liable to pay losses for the overrun period, thereby relying on *The Achilleas*. The arbitrators found in the charterer’s favor and awarded USD 273,706.12 in damages. The court on appeal agreed with the Tribunal’s findings. With respect to the “assumption of responsibility” test in *The Achilleas*, Hamblen J argued at paragraph 1:

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<sup>35</sup> For a thorough analysis of the case and its implications, see for example Guenter Treitel, *The Law of Contract* (13th edn, Sweet & Maxwell 2011) paras 20-110 - 20-112 and Harvey McGregor, *McGregor on Damages* (18th edn, Sweet & Maxwell 2009) paras 6-165 - 6-173

<sup>36</sup> Bernard Eder and others, *Scrutton on Charterparties and Bills of Lading* (22nd edn, Sweet & Maxwell 2011) para 19-005. Example cases are *Note Asm Shipping Ltd. of India v TTMI Ltd. of England (The Amer Energy)* [2009] 1 Lloyd’s Rep 293, *Supershield Ltd. v Siemens Building Technologies FE Ltd.* [2010] EWCA Civ 7; [2010] 1 CLC 241, *Sylvia Shipping Co. Ltd. v Progress Bulk Carriers Ltd. (The Sylvia)* [2010] EWHC 542 (Comm).

<sup>37</sup> *Sylvia Shipping Co. Ltd. v Progress Bulk Carriers Ltd. (The Sylvia)* [2010] EWHC 542 (Comm)

The decision in *The Achilleas* resulted in an amalgam of the orthodox approach to remoteness and a broader approach involving the assumption of responsibility. The orthodox approach remained the general test of remoteness applicable in the great majority of cases. However, there might be unusual cases, such as *The Achilleas* itself, in which the context, surrounding circumstances or general understanding in the relevant market made it necessary specifically to consider whether there had been an assumption of responsibility. That was most likely to be in those relatively rare cases where the application of the general test led or might lead to an unquantifiable, unpredictable, uncontrollable or disproportionate liability or where there was clear evidence that such a liability would be contrary to market understanding and expectations. In the great majority of cases it would not be necessary specifically to address the issue of assumption of responsibility.

Thus, from this and various other post-*Achilleas* judgments<sup>38</sup> it becomes clear that the “assumption of responsibility” test is to be applied only in very rare circumstances and that the test in *Hadley v Baxendale* is still the leading case in remoteness of damage.

### **3 Exemption Clauses and Consequential Loss**

#### **3.1 Introduction**

This work is going to focus on consequential losses and contractual clauses exempting liability for such losses<sup>39</sup>. This chapter is going to give an introduction to exemption clauses, what they aim at and how they are regulated by statute. Afterwards, authoritative case law concerning the construction of clauses excluding liability for consequential losses is going to be analyzed. Eventually, criticism about the court’s interpretation of exemption clauses is going to be highlighted.

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<sup>38</sup> See footnote 36

<sup>39</sup> For information about judicial and legislative control of exclusion clauses see Richard Lawson, *Exclusion Clauses and Unfair Contract Terms* (10th edn, Sweet & Maxwell 2011)



### 3.2 The Purpose of Exemption Clauses

Generally, there is freedom of contract so parties to a contract are free to include an exemption clause in their contract. The aim of an exemption clause is to exclude or limit liability. For example, it is common in contracts to exclude liability for losses arising out of breach of contract, to limit liability to cases of willful neglect or to introduce a clause limiting the time within which claims can be submitted, etc.<sup>40</sup> An exemption clause can only be enforceable if it is incorporated into the contract as a term and if it covers the loss it was designed for.<sup>41</sup>

### 3.3 Limitation by Statute: UCTA 1977 and UTCCR 1999

Although there is freedom of contract exemption clauses may nevertheless be rendered unenforceable by statute. The relevant Acts in English law are the Unfair Contract Terms Act (UCTA) 1977 and the Unfair Terms in Consumer Contracts Regulations (UTCCR) 1999. UCTA 1977 mainly refers to clauses whose purpose it is to exclude or limit liability. However, following the Law Commission's report on UCTA 1977 and UTCCR 1999<sup>42</sup>, UCTA 1977 does not apply to, inter alia, marine salvage or towage contracts, charter parties and contracts for the carriage of goods by sea except for when they contain clauses which exclude or limit liability for negligence of breach of duty with regards to death or personal injury.

Thus, as the focus of this work is on exemption clauses in the context of charter parties, UCTA 1977 and UTCCR 1999 do not apply. Therefore, the contents of UCTA 1977 and UTCCR 1999 will not be further elaborated on.

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<sup>40</sup> Joseph Chitty and H. G. Beale, *Chitty on Contracts* (30th edn, Sweet & Maxwell 2008) para 14-003

<sup>41</sup> Guenter Treitel, *The Law of Contract* (13th edn, Sweet & Maxwell 2011) 237 para 7-003

<sup>42</sup> Law Commission and Scottish Law Commission, *Unfair Terms in Contracts* (Law Com No 292, Scot Law Com No 199, 2005) para 4.81

<[http://lawcommission.justice.gov.uk/docs/lc292\\_Unfair\\_Terms\\_In\\_Contracts.pdf](http://lawcommission.justice.gov.uk/docs/lc292_Unfair_Terms_In_Contracts.pdf)> accessed 09 September 2013

### 3.4 The Definition of “Consequential Loss” and the Construction of Exemption Clauses in General Law of Contract

#### 3.4.1 Introduction

Courts are frequently faced with cases in which the parties claim damages which are both of direct and indirect or consequential nature. It is up to the court to decide whether the damages claimed are recoverable or whether they are too remote to be recoverable. The remoteness test established in *Hadley v Baxendale*<sup>43</sup> is being used in order to determine whether damages are recoverable or not. A difficulty arises if the parties to a contract included a clause exempting liability for indirect or consequential losses in their contract because one has to define what indirect and consequential losses are. If such a clause is included in a contract and a breach occurs the question arises which of the losses claimed are recoverable because they are of direct nature and which losses are not because they are indirect or consequential and fall under the exemption clause in the contract.

There is authority which indicates that the delimitation between direct and indirect or consequential losses is found in the two limbs test in *Hadley v Baxendale*. This means that direct losses are those which result naturally from a breach of contract and fall under the first limb of the rule in *Hadley v Baxendale* while indirect or consequential losses incur due to special circumstances and fall under the second limb of the rule. Recoverability may then be dependent on whether the losses were in the reasonable contemplation of the contract breaker to be likely to occur as a consequence of the breach at the time the contract was entered into.

However, equating direct and indirect or consequential losses with the first and second limb of the rule in *Hadley v Baxendale* is not an established principle. Rather, it appears like some courts take it for granted that this is true while others draw the distinction differently. There is both case law and literature which is of a different view and takes another approach to distinguish direct from indirect or consequential losses.

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<sup>43</sup> See ch 2.3.2

This chapter is going to focus on general contract law cases which deal with the distinction between direct and consequential losses in the context of exemption clauses. It will become apparent that there is no unanimous approach of interpretation and construction by the courts. The cases have authoritative character with respect to the definition of direct and consequential loss and are referred to by McGregor<sup>44</sup> in the chapter about normal and consequential losses. Furthermore, *BHP Petroleum v British Steel*<sup>45</sup> was added to this chapter because it is quoted from and referred to in *Hotel Services v Hilton International Hotels*<sup>46</sup>. *Markerstudy Insurance Company v Endsleigh Insurance Services*<sup>47</sup> which was decided in 2010 represents a very recent case which dealt with the interpretation of an exemption clause. The focus of this case is, however, on the syntax of the exemption clause.

#### 3.4.2 Millar's Machinery Co. Ltd. v David Way and Son (1934)

An early case which interpreted the term "consequential" in an exemption clause is the Court of Appeal decision in *Millar's Machinery Co. Ltd. v David Way and Son*<sup>48</sup>. The case concerned the sale of a machine which was delivered with delay. The purchaser had paid a deposit which he sought to recover along with costs he incurred for the supply of a replacement machine. The sales contract contained a clause saying 'We do not give any other guarantee and we do not accept responsibility for consequential damages'. It was held that the losses were recoverable and did not fall under the exemption clause because they 'resulted directly and naturally from the plaintiffs' breach of contract'. Maugham LJ stated that 'On the question of damages, the word "consequential" had come to mean "not direct", and the damages recovered by the defendants on the counterclaim arose directly from the plaintiffs' breach of contract under section 51(2) of the Sale of Goods Act, 1893'. This case

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<sup>44</sup> Harvey McGregor, *McGregor on Damages* (18th edn, Sweet & Maxwell 2009) para 1-037, although McGregor does not refer to *BHP Petroleum v British Steel* and *Markerstudy Insurance Company v Endsleigh Insurance Services*

<sup>45</sup> Ch 3.4.6

<sup>46</sup> Ch 3.4.7

<sup>47</sup> Ch 3.4.9

<sup>48</sup> (1934) 40 Com. Cas. 204

is being referred to in many later cases which deal with the interpretation of exemption clauses.<sup>49</sup>

### 3.4.3 Croudace Construction Ltd. v Cawoods Concrete Products Ltd. (1978)

The approach to equate consequential losses with those falling under the second limb in *Hadley* was applied by the Court of Appeal in *Croudace Construction Ltd. v Cawoods Concrete Products Ltd.*<sup>50</sup>. The case concerned the delivery of concrete blocks. These concrete blocks were alleged to have been delivered in defective condition and, in addition, late. Therefore, *Croudace* sued *Cawoods* for, inter alia, loss of productivity, inflation costs and a claim from a sub-contractor. *Cawoods* relied upon an exemption clause which read:

We are not under any circumstances to be liable for any consequential loss or damage caused or arising by reason of late supply or any fault, failure or defect in any materials or goods supplied by us or by reason of the same not being of the quality or specification ordered or by reason of any other matter whatsoever.

At page 58, Parker J, the judge at first instance, stated that ‘(...) the word "consequential" has no well defined meaning and may have different meanings according to the context in which it is used’. In the analysis of the exclusion clause he went on as follows on page 58:

The problem is, therefore, to determine, in effect, what it was which was intended to survive the exclusion. (...) For the plaintiffs, it is contended that all loss and damage survives save only such damage as, in the absence of the clause, would only have been recoverable on proof of special circumstances. Put another way, it is submitted that nothing is within the word "consequential" if it directly and naturally results in the ordinary course of events from the late delivery. It is in my judgment

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<sup>49</sup> For example in *Croudace Construction Ltd. v Cawoods Concrete Products Ltd.* [1978] 2 Lloyd’s Rep 55, *British Sugar Plc. v NEI Power Projects Ltd. and ANR* [1997] EWCA Civ 2438, *Hotel Services Ltd. v Hilton International Hotels (UK) Ltd.* [2000] EWCA Civ 74

<sup>50</sup> [1978] 2 Lloyd’s Rep 55

clear that the word "consequential" is, in the present context, used to describe or indicate a type of loss or damage which is in some way less direct or more remote than that loss or damage which is to remain recoverable despite the exclusion. This appears to me to follow from the ordinary use of the words and from the fact that it would be commercial nonsense to give it any other meaning.

Eventually, both the first instance court and the Court of Appeal followed the interpretation of the term "consequential" which was provided in *Millar's Machinery Co. Ltd. v David Way and Son*<sup>51,52</sup> as they deemed the exemption clauses to be similar enough. The appeal was dismissed on the grounds that the Court of Appeal agreed with Parker J that 'the word "consequential" does not cover any loss which directly and naturally results in the ordinary course of events from late delivery'.

Although the judges do not explicitly equate consequential losses with those falling under the second limb in *Hadley v Baxendale*, the language they use is nonetheless the same as in *Hadley v Baxendale*. In particular, 'resulting directly and naturally from the breach' is the language used to describe losses falling under the first limb in *Hadley v Baxendale*.<sup>53</sup> The court held that the losses claimed in *Croudace v Cawoods* were a direct and natural consequence of the late delivery of the concrete blocks. Therefore, the losses were not consequential and were not covered by the exemption clause.

#### 3.4.4 British Sugar Plc. v NEI Power Projects Ltd. and ANR (1997)

In the 1997 Court of Appeal decision *British Sugar Plc. v NEI Power Projects Ltd. and ANR*<sup>54</sup> the court found lost profits to be direct and natural results of a breach of contract and

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<sup>51</sup> (1934) 40 Com. Cas. 204

<sup>52</sup> For details of the case see ch 3.4.2

<sup>53</sup> McGregor, at para 1-037, is of the opinion that both, *Millar's Machinery* and *Croudace* were decided under the assumption that consequential losses would be those falling under the second limb of the rule in *Hadley v Baxendale*

<sup>54</sup> [1997] EWCA Civ 2438

therefore not to be of consequential nature. *British Sugar* had contracted with *NEI* for the design, supply, delivery, testing and commissioning of electrical equipment. *British Sugar* alleged that the equipment was poorly designed and badly installed. As a consequence thereof, power supply breakdowns occurred and *British Sugar* claimed damages over GBP 5,000,000 for mainly increased production costs and lost profits.

The contract contained a clause which limited *NEI's* liability for consequential damages to the value of the contract. The value of the contract was said to be GBP 106,585. In its reasoning the court referred to two Court of Appeal judgments in which similar clauses were analyzed with the same outcome: *Millar's Machinery Co. Ltd. v David Way & Son*<sup>55</sup> and *Croudace Construction Ltd. v Cawoods Concrete Products Ltd.*<sup>56, 57</sup> The Court of Appeal confirmed the High Court's findings that lost profits and increased production costs did not fall under the protection of the clause and that *British Sugar* could recover their losses. In addition, Waller LJ (with whom Evans and Aldous LJ agreed) rejected the submission that consequential loss, to a reasonable businessman, would include loss of profits. With respect to the remoteness test in *Hadley v Baxendale*, the Court argued that lost profits could be a direct and natural result of a breach of contract.

#### 3.4.5 Deepak Fertilisers and Petrochemical Corporation v Davy McKee and ICI Chemicals & Polymers Ltd. (1999)

A case in which the court gave an interesting reasoning is *Deepak Fertilisers and Petrochemical Corporation v Davy McKee and ICI Chemicals & Polymers Ltd.*<sup>58</sup>. *Deepak* had built a methanol plant with the help of the know-how and technology of *ICI*. As soon as the plant had entered into service there were problems with the methanol converter. The problems continued and a year after the plant had commenced operation the methanol converter exploded. The production ceased completely while the plant was rebuilt. *Deepak* claimed

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<sup>55</sup> (1935) 40 Com Cas 204

<sup>56</sup> [1978] 2 Lloyd's Rep 55, see ch 3.4.3

<sup>57</sup> See discussions of these cases in ch 3.4.2 and ch 3.4.3

<sup>58</sup> [1999] 1 Lloyd's Rep 387

from *ICI* costs of reconstruction, fixed costs and overheads incurred while the plant was being rebuilt and lost profits for the time the plant was out of service, amounting to over GBP 100,000,000 including interest. The contract contained an exemption clause which read:

Davy does not assume any liability except as expressly set out in the contract and in no event shall Davy, by reason of its performance or obligation under this contract, be liable in tort or for loss of anticipated profits, catalyst, raw material and products or for indirect or consequential damages

At first instance, *Deepak* was awarded costs for reconstruction of the plant but failed with their other claims since they would fall within the exception. The Court of Appeal, however, held that *Deepak* could recover not only the costs of reconstruction but also wasted overheads since they were as much a direct consequence of the explosion as the reconstruction of the plant. Furthermore, Stuart-Smith LJ, at paragraph 90, held that lost profits were not recoverable but this was because they were explicitly exempted in the contract and not because they were too remote to be recoverable. He stated as follows:

The direct and natural result of the destruction of the plant was that Deepak was left without a Methanol plant, the reconstruction of which would cost money and take time, losing for Deepak any methanol production in the meantime. Wasted overheads incurred during the reconstruction of the plant, as well as profits lost during that period, are no more remote as losses than the cost of reconstruction. Lost profits cannot be recovered because they are excluded in terms, not because they are too remote. We consider that this Court is bound by the decision in *Croudace* where a similar loss was not excluded by a similar exclusion and considered to be direct loss.

In this case no reference was made to the two limbs test in *Hadley v Baxendale*.

### 3.4.6 BHP Petroleum Ltd. and Others v British Steel Plc. and Dalmine SpA. (2000)

A case in which it was particularly stated that consequential or indirect losses are those which fall under the second limb of the rule in *Hadley v Baxendale* is the Court of Appeal's decision in *BHP Petroleum Ltd. and Others v British Steel Plc. and Dalmine SpA*.<sup>59</sup> The case concerned a contract for the supply of steel pipes for a gas reinjection pipeline which was to be installed offshore. The pipeline was supposed to carry gases which formed during the process of oil production to an unmanned platform. The pipeline was installed in spring 1994 and entered into service in April 1996. No defects were observed until June 1996 when bubbles were seen at the surface. This indicated that the pipeline was leaking. Owing to this *BHP* claimed that the delivered steel pipes did not meet the specifications and therefore sued *British Steel* as the suppliers and *Dalmine* as the manufacturers of the steel pipes for inspection costs, repair costs, costs for the installation of additional equipment while the pipeline was out of service, lost profits and deferred production.

The contract contained an exemption clause which excluded both parties' liability for 'loss of production, loss of profits, loss of business or any other indirect loss or consequential damages arising during and/or as a result of the performance or non-performance of this Contract (...)'. The question that both Rix J at first instance and the Court of Appeal had to deal with was whether the claims pleaded by *BHP* were loss of production, loss of profits, loss of business or any other indirect losses or consequential damages and would therefore not be recoverable because they fell under the exemption clause.

Rix J considered the meaning of the term "indirect losses or consequential damages" and found himself bound by authority to hold that these damages were those which fell under the second limb of the rule in *Hadley v Baxendale*. Furthermore, he found that the state of knowledge of the parties at the time the contract is entered into is the decisive factor in determining whether losses are recoverable or not. The Court of Appeal cited Rix J's findings

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<sup>59</sup> (2000) 2 Lloyd's Rep 277



but did not comment further on the issue because the parties did not seek to take this before the Court of Appeal.

One particular claim the court had to deal with was for deferred production. Apparently, this was also the largest claim. *BHP* claimed a loss which was incurred because the extraction of oil and gas from the plant was deferred and the attainment of maximum production levels was delayed due to the alleged breaches of contract. Therefore, the expected revenues had been and would be deferred. After all, the production of oil and gas was finite and therefore the amount of oil and gas produced would be the same eventually. The difference was only the time at which the production was made. The claim was for the difference of the capital value of the income without the breach of contract and with the breach of contract, thus the capital value at two different points of time. *BHP's* main argument was that this loss was not loss of production, loss of profits or loss of business because the oil and gas had not been lost but its production had only been delayed. Obviously, *BHP* attempted to keep the claim outside the scope of the exemption clause.

Both, the judge at first instance and May LJ rejected *BHP's* argument and found these losses to fall under the exemption clause. They both were of the opinion that the general understanding was that when production ceased or was reduced, there was loss of production, even if it was recovered at a later stage. Moreover, they argued that if there is deferred production, there is both a loss of profit and a loss of business.

In terms of the definition of consequential losses this case is another example in which these losses are equated with the second limb of the rule in *Hadley v Baxendale*, thus knowledge of the parties about special circumstances of the contract is required in order to decide whether these losses are recoverable or too remote.

### 3.4.7 Hotel Services Ltd. v Hilton International Hotels (UK) Ltd. (2000)

Another case concerned with the construction of an exemption clause is *Hotel Services Ltd. v Hilton International Hotels (UK) Ltd.*<sup>60</sup>. *Hotel Services* and *Hilton* entered into a rental agreement for minibars which could in a particular way register the hotel guest's consumption, called "robobars". These robobars were developed and promoted by *Hotel Services* and their aim was to make sure that hotel guests would pay for everything they took from the minibar. Eventually, the robobars turned out to be problematical for various reasons and *Hilton* therefore started to remove the robobars from their hotel rooms. *Hilton* claimed, inter alia, the costs for removing the robobars and GBP 127,000 in lost profits because they could not use the robobars as contracted for and accordingly did not make the profit that *Hotel Services* promised *Hilton* would make by using the robobars instead of regular minibars. The contract contained an exemption clause which read:

The Company [HSL] will not in any circumstances be liable for any indirect or consequential loss, damage or liability arising from any defect in or failure of the System or any part thereof or the performance of this Agreement or any breach hereof by the Company or its employees.

In its reasoning, the Court of Appeal referred to a number of decisions, including *Victoria Laundry, Deepak, BHP Petroleum, Croudace* and *British Sugar* and eventually held that both the costs for removal and the lost profits claimed by *Hilton* were a direct consequence of the breach and therefore fell outside the scope of the exemption clause. Sedley LJ held at paragraph 20:

We prefer therefore to decide this case, much as *Victoria Laundry* was decided, on the direct ground that if equipment rented out for selling drinks without defalcations turns out to be unusable and possibly dangerous, it requires no special mutually known fact to establish the immediacy both of the consequent cost of putting it where it can do no harm and - if when in use it was showing a direct profit - of the

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<sup>60</sup> [2000] EWCA Civ 74

consequent loss of profit. Such losses are not embraced by the exclusion clause, read in its documentary and commercial context. We would accordingly dismiss this appeal.

From the reasoning of the court it becomes clear that it found it difficult to decide the case. In order to reach its conclusion, the court in detail analyzed various preceding decisions, most of which are found in this work as well.<sup>61</sup> In paragraph 19 the court quoted from Rix J's first instance decision in *BHP Petroleum*<sup>62</sup> that 'the parties are correct to agree that authority dictates that the line between direct and indirect or consequential losses is drawn along the boundary between the first and second limbs of *Hadley v Baxendale*'. The court made a point to say that it is not easy to say on which side of the line a loss falls and that there is no general rule. Rather, the surrounding facts of each individual case need to be taken into consideration when deciding whether losses, in particular lost profits, are of direct or consequential nature and therefore embraced by an exemption clause.

#### 3.4.8 *Watford Electronics Ltd. v Sanderson CFL Ltd* (2001)

A further example where direct and consequential losses were determined based on the remoteness test in *Hadley v Baxendale* is *Watford Electronics Ltd. v Sanderson CFL Ltd.*<sup>63</sup>. This case concerned the sale of a computer system from *Sanderson* to *Watford*. *Watford* who were suppliers of computer products themselves bought standard software which required some modification from *Sanderson*. Three contractual documents were exchanged: A sales contract, a software license and a software modification license. Eventually, the system did not work as contracted for and *Watford* sued *Sanderson* for, inter alia, breach of contract and negligent misrepresentation. The sales contract contained an exemption clause which read:

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<sup>61</sup> For example *Hadley*, *Victoria Laundry*, *Millar's Machinery*, *Croudace*, *British Sugar* and *Deepak*

<sup>62</sup> See ch 3.4.6

<sup>63</sup> [2001] EWCA Civ 317

Neither the Company nor the Customer shall be liable to the other for any claims for indirect or consequential losses whether arising from negligence or otherwise. In no event shall the Company's liability under the Contract exceed the price paid by the Customer to the Company for the Equipment connected with any claim.

The combined limit of liability under the various agreements was about GBP 140,000. The direct losses claimed by *Watford* amounted to about GBP 120,000 while the indirect or consequential losses were significantly higher, amounting to almost GBP 5,500,000. Since the indirect or consequential losses allegedly incurred by *Watford* exceeded the limitation amount in such a significant manner, *Watford* claimed that the exclusion clause did not satisfy the requirement of “reasonableness”<sup>64</sup> in accordance with section 11(1) of the Unfair Contract Terms Act (UCTA) 1977<sup>65</sup>. Accordingly, this was the main issue in the case.

Thornton J at first instance found that the clause did not satisfy the requirements of UCTA 1977 and that the clause was unreasonable. However, Chadwick LJ, with whom Buckley J and Peter Gibson LJ agreed, came to the opposite conclusion after having reviewed the requirements set out in UCTA 1977 and deemed the clause to be valid. Owing to this, the exemption clause could be relied on by Sanderson and the indirect or consequential losses could not be claimed. With regards to the content of the exemption clause Chadwick LJ, at paragraph 36, stated as follows:

The purpose of the first sentence of the clause is (at the least) to exclude contractual claims for indirect and consequential losses; that is to say, to exclude liability in contract for losses which could be recovered only under the second limb of the rule in *Hadley v Baxendale*. Those are losses which do not result “directly and naturally” from the breach; but which, nevertheless, were or must reasonably be supposed to have been in the contemplation of both parties at the time when the contract was made.

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<sup>64</sup> For more information regarding the requirement of reasonableness see for example Richard Lawson, *Exclusion Clauses and Unfair Contract Terms* (10th edn, Sweet & Maxwell 2011) paras 9.01 - 9.26

<sup>65</sup> See further on UCTA 1977 in ch 3.3

Thus, Chadwick LJ expressly equated indirect and consequential losses with losses falling under the second limb in *Hadley v Baxendale*.

### 3.4.9 Markerstudy Insurance Company Ltd. and Others v Endsleigh Insurance Services Ltd. (2010)

The interpretation of an exemption clause was one of the main issues the High Court dealt with in *Markerstudy Insurance Company Ltd. and Others v Endsleigh Insurance Services Ltd.*<sup>66</sup>. The case was about alleged breaches of claims handling agreements by the defendant which resulted in an alleged loss of about GBP 14,000,000. The claimant pleaded to have suffered six categories of loss:

- i) The payment out of unnecessary sums on claims;
- ii) The inaccurate reserving of claims;
- iii) Delays in passing on claims documentation;
- iv) Disruption to business in addressing the consequences of such delays;
- v) The over-reserving of claims;
- vi) Interest by way of damages.

The claims handling agreement contained an exemption clause which read:

Neither party shall be liable to the other for any indirect or consequential loss (including but not limited to loss of goodwill, loss of business, loss of anticipated profits or savings and all other pure economic loss) arising out of or in connection with this Agreement.

The claimant argued that the clause exempted the defendant only from liability for indirect or consequential losses. The defendant, on the other hand, claimed that it exempted him not only from indirect or consequential loss but also for direct loss in the categories of loss

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<sup>66</sup> [2010] EWHC 281 (Comm)

listed in parentheses in the exemption clause, ie loss of goodwill, loss of business, loss of anticipated profits or savings and all other pure economic loss.

The court had to deal with the question which of the two opposed interpretations of the clause was the correct one, if any. The court mainly referred to two judgments in which exemption clauses were interpreted: *BHP Petroleum v British Steel*<sup>67</sup> and *Ferryways NV v Associated British Ports*<sup>68</sup>.

David Steel J held at paragraph 17:

The clause in the present case must be construed on its own terms. There is nothing in the factual background at the time of the execution of the agreement that throws light on the intention of the parties. In my judgment the Claimants' construction is to be preferred:

- i) The use of the phrase "including but not limited to" is a strong pointer that the specified heads of loss are but examples of the excluded indirect loss.
- ii) The elevation of all "pure economic loss" as a freestanding category for which liability is excluded potentially cuts across recovery of even direct loss: yet it is Clause 13.2 which furnishes the "limit" to direct loss recovery.
- iii) As in *Ferryways* the purported exclusion of the specified categories of loss in both direct and indirect form is not expressed clearly.

The court held that the exemption clause which excludes liability for "indirect or consequential losses" and then lists various types of losses, like loss of business, in parentheses, must be understood to mean that the losses named in parentheses are mere examples of indirect or consequential losses.

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<sup>67</sup> See ch 3.4.6

<sup>68</sup> [2008] 1 Lloyd's Rep 639

Accordingly, this case makes it obvious that when drafting an exemption clause, parties to a contract must pay particular attention to the syntax of their clause in order to make sure that it is in conformity with the parties' intention.

#### 3.4.10 Conclusion

The cases analyzed in the preceding chapters 3.4.2 to 3.4.9 concern the interpretation of the term "consequential or indirect loss" in the context of exemption clauses. The courts' reasonings make it obvious that there is no clear-cut definition of consequential or indirect losses. Rather, it was seen that some courts see the definition in the second limb of the rule in *Hadley v Baxendale* while others added a note of caution to this interpretation as they deem that all the surrounding facts of each individual case need to be taken into account when deciding whether losses are of consequential nature or not. Furthermore, not only the wording but also the syntax of a clause may be decisive when it comes to the question which type of loss is covered by it and which type is not.

### 3.5 Different Definitions of Consequential Loss

#### 3.5.1 Introduction

The cases presented in the previous chapter have shown that there is no single definition of the term consequential loss in the context of exemption clauses. Many cases have been decided under the assumption that consequential losses are those which fall under the second limb of the rule in *Hadley v Baxendale*. However, there is criticism of this approach which will be highlighted in this chapter.

#### 3.5.2 McGregor on Damages

The preceding chapters have presented authority which defines consequential losses as falling under the second limb of the rule in *Hadley v Baxendale*. McGregor<sup>69</sup>, however, does

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<sup>69</sup> Harvey McGregor, *McGregor on Damages* (18th edn, Sweet & Maxwell 2009)

not support this view. Rather, he claims that a consequential loss might as well derive naturally from a breach of contract and would therefore fall under the first limb of the rule in *Hadley v Baxendale*. This would depend on the nature and type of contract. At paragraph 1-036 McGregor defines normal and consequential losses as follows:

The normal loss is that loss which every claimant in a like situation will suffer; the consequential loss is that loss which is special to the circumstances of the particular claimant. [...] 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. The distinction is not the same as that between the first and the second rules in *Hadley v Baxendale*: a consequential loss may well be within the first rule.

After a review of the authorities<sup>70</sup> with regards to the definition of consequential losses falling within the second limb of the rule in *Hadley v Baxendale* in the context of exclusion clauses, McGregor states at paragraph 1-038:

It is also illogical and fails to make practical sense to confine consequential loss in contract to loss falling within the second rule in *Hadley v Baxendale*, being contradictory for one contracting party to communicate special circumstances to the other so as to fix him with a liability for loss to which he would not otherwise be subject and at the same time to accept an exclusion of liability in respect of the selfsame loss.

Accordingly, McGregor appropriately addresses the issue that there is no final definition of consequential or indirect loss in case law. Furthermore, his argument that the interpretation of consequential losses falling within the second limb of the rule in *Hadley v Baxendale* is contradictory to the idea of second limb losses, ie that a party to a contract can only be held

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<sup>70</sup> McGregor reviews *Millar's Machinery*, *Croudace*, *British Sugar*, *Deepak*, *Hotel Services* and *Watford Electronics* which are analyzed in detail in this work as well



liable for these losses if it was communicated the special circumstances which lead to the loss beforehand, is particularly convincing and is worth being considered by a court.

### 3.5.3 Lord Hoffmann in *Caledonia North Sea Ltd. v British Telecommunications Plc.* (2002)

Besides McGregor, Lord Hoffmann in the 2002 House of Lords decision *Caledonia North Sea Ltd. v British Telecommunications Plc.*<sup>71</sup> also addressed the issue of how consequential losses in the context of exemption clauses shall be defined. The case concerned the explosion of an oil platform in the North Sea in 1988 during which several workers had been killed or injured. The issue the instances had to deal with was for indemnities for death and personal injury claims between the operator of the oil platform and its various contractors.

The contract between the parties contained an exemption clause which excluded liability ‘for any indirect or consequential losses suffered, including but not limited to, loss of use, loss of profits, loss of production or business interruption’. One of the parties submitted in their defense that this clause exempted them from parts of their liability, thereby arguing that indirect or consequential losses should be construed to mean losses which would have been recoverable under the second limb of the rule in *Hadley v Baxendale*.

Lord Hoffmann, at paragraph 100, expressed his doubts as to whether the approach to equate consequential losses with those falling under the second limb in *Hadley v Baxendale* was appropriate. In particular, his words were that he wished ‘to reserve the question of whether, in the context of the contracts in the Hotel Services and similar cases, the construction adopted by the Court of Appeal was correct’.

However, Lord Hoffmann did not evaluate further on this question for he did not deem the exemption clause to be of any relevance to the case. This was because it concerned limitation of liability for breach of contract while the claim dealt with an indemnity for a liability incurred outside the contract. Thus, albeit there was no particular ruling with respect to the

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<sup>71</sup> [2002] 1 Lloyd’s Rep 553

definition of consequential or indirect losses, Lord Hoffmann's view which is in support of McGregor's approach should nevertheless be kept in mind when construing consequential losses, for example in the context of exemption clauses.

### 3.6 Conclusion

From the cases and literature analyzed above it becomes clear that there is no unanimous definition of direct and consequential losses. The two limbs test is one approach to delimitate direct from consequential losses. However, although this test has been used in various cases, there is criticism from Lord Hoffmann and McGregor about its use. *McGregor on Damages* is authoritative commentary on English law of contract and is commonly referred to by English courts<sup>72</sup>. Accordingly, both Lord Hoffmann's as well as McGregor's views do have significant value and it does not seem to be unlikely that their views will be further elaborated on in future cases, with the possible outcome of an established principle which defines direct and consequential losses.

The cases analyzed in this chapter make one problem particularly clear: There is no established principle of what consequential losses are although companies commonly attempt to exclude liability for them in their contracts. All of the exemption clauses which have been tested in the cases presented in this chapter aimed at excluding liability for consequential losses. Obviously, the parties to the contract did have particular losses in mind which their exemption clause was supposed to cover. From the wordings of the exemption clauses used the contracting parties must have had losses like lost profits, loss of production and loss of business in mind when drafting their exemption clause. Most likely because these type of losses are rather difficult to anticipate at the outset. Thus, the risk involved in accepting liability for such losses in case of breach of contract appears to be too high as such losses may easily reach very high dimensions. For example, in *Deepak Fertilisers and Petro-*

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<sup>72</sup> For example in the following cases which form part of this work: *Caledonia North Sea Ltd. v British Telecommunications Plc.*, *Transfield Shipping Inc. v Mercator Shipping Inc. (The Achilleas)*, *British Sugar Plc. v NEI Power Projects Ltd.*, *Croudace Construction Ltd. v Cawoods Concrete Products Ltd.*

*chemical Corporation v Davy McKee and ICI Chemicals & Polymers Ltd.*<sup>73</sup> the claims amounted to more than GBP 100,000,000 and included not only costs for reconstructing the destroyed methanol plant but also fixed costs and overheads which had incurred while the plant was being rebuilt and lost profits while the plant was out of service. Although the exemption clause excluded liability for indirect or consequential damages the court nevertheless defined all the losses claimed as direct losses, resulting directly from the explosion of the plant and thus from the breach of contract. Consequently, clauses exempting liability for consequential losses do not always hold what their drafters intended them to hold.

## 4 Consequential Loss in Charter Parties

### 4.1 Introduction

This and the following chapters are going to focus on consequential losses in a charter party context as well as exemption clauses used in charter parties. In the context of charter parties consequential losses arising due to breach of a charter party provision can easily become quite extensive. The purpose of this chapter is first of all to illustrate what consequential losses in the context of charter parties can consist of and what dimensions they can reach. The cases presented in this chapter have particular interesting interpretations of the rules on remoteness. More precisely, the losses awarded are of a kind which would not fall under the first limb of the rule in *Hadley v Baxendale*. Rather, these losses stem, for example, from a charterer's sub-contract which an owner does not have any knowledge of. The court's reasoning is, for instance, that the owner ought to have known that such contracts would be in existence, although the owner does not have actual knowledge thereof. Consequently, it is even difficult to define such losses to be falling under the second limb of the rule in *Hadley v Baxendale*, as this would require knowledge of special circumstances shared among the contracting parties at the time of the contract. Apparently, the courts in the cases presented in this chapter deemed that such knowledge need not be actual but only implied.

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<sup>73</sup> See ch 3.4.5

*The Achilleas*<sup>74</sup> and *The Heron II*<sup>75</sup> are important cases with regards to remoteness and the recoverability of consequential losses in a charter party context, too, and would have fit into this chapter as well. However, since a thorough discussion is provided in chapter 2.3 in the context of remoteness, these cases are not going to be presented in this chapter again.

From the following cases as well as *The Achilleas* and *The Heron II* it will become clear that shipowners (respectively charterers in *The Achilleas*) are faced with a considerable risk to be liable for very remote losses when they are in breach of a charter party term. A few standard charter parties do have exemption clauses and later in this work these clauses will be examined, also with respect to case law and the findings of the previous chapter on exemption clauses in general law of contract.

With the help of the findings of the previous, the present and the following chapters, a recommendation with respect to how an exemption clause could be worded in order to meet the parties' intentions will be provided in the final conclusion.

## **4.2 The Balears (1993)**

The 1993 House of Lords judgment in *The Balears*<sup>76</sup> is a decision in which the shipowners were held responsible for the charterer's trading losses. The matter went into arbitration where the charterers were successful in their claim. The Court of Appeal set aside the award but the House of Lords restored it and reconfirmed the Tribunal's findings on remoteness of damage.

The vessel was chartered for a voyage on an ASBATANKVOY form to load 30,000 metric tons 5% more or less in owner's option refrigerated LPG in Bethioua, Algeria for discharge in various ports to be nominated by charterers. The owners knew that the charterers' supplier was the Algerian state-controlled LPG trading organization. The charter party con-

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<sup>74</sup> [2008] UKHL 48, [2009] 1 AC 61, a detailed review of the case is provided in ch 2.3.4

<sup>75</sup> [1969] 1 AC 350, a detailed review of the case is provided in ch 2.3.3

<sup>76</sup> *Geogas S.A. v Trammo Gas Ltd. (The Balears)* [1993] 1 Lloyd's Rep. 215

tained a provision stating the vessel's expected readiness date. Further, the charter party stated that the vessel should proceed with all convenient dispatch to the load port.

Ten days before the agreed commencement of laytime and eleven days prior to the "expected readiness" date the owners suggested substituting the vessel which was allowed according to the charter party terms. At the same time, they also informed the charterers that the suggested substitute vessel would not meet the cancelling date and offered a later laycan. Further, the owners advised that M/V Baleares would not meet the laycan. One day after expiry of the laycan the charterers cancelled the charter party.

The matter went into arbitration and the charterers based their claim on

- (1) Breach of contract for having given an ETA "without any basis of reasonable grounds for believing that the same would or could be complied with",
- (2) Breach of an implied obligation to proceed in such a manner to be certain to arrive at the ETA date and
- (3) Negligent misrepresentation.

The charterers based their claim amount on three different alternative bases:

- (1) The difference in market value of the entire cargo between 103 USD/mt which was the price they allegedly would have paid on or around the ETA date and 205 USD/mt which was the price they would have paid after the cancelling date, amounting to approximately USD 3,000,000 or
- (2) USD 2,057,392 in an indemnity for having settled their purchaser's claims for the non-delivery of the LPG or
- (3) At least 50 USD/mt which was an alleged rise in the spot price of Algerian LPG which occurred once it became known that M/V Baleares would arrive late in Bethioua, totaling USD 1,500,000.

The owners denied liability and argued that even if they were in breach of contract the damages would have to be calculated with regards to the rules of remoteness. The arbitrators found that the ETA, in light of the vessel's previous obligations, was unrealistic and that the owners "would have done well" to meet the cancelling date. Therefore, the Tribunal found that the owners were in breach of contract with regards to (1) the provided ETA which they had no grounds to believe could be complied with and (2) an implied obligation to proceed in such a manner to be certain to meet the ETA. The claim based on misrepresentation was rejected as it was deemed to be neither material nor causative to the alleged loss.

With respect to the losses claimed the Tribunal refused the charterer's first alternative claim because the charter party did not contain any provision that the ship would have had to start loading on the ETA date. Had the vessel arrived shortly before midnight on the ETA date the loading would not have started and the charterers could have been faced with the alleged loss even if there had been no breach.

The arbitrators also refused the claim for indemnity for the settlements entered into with the charterer's purchasers because they were not convinced that the losses were incurred due to the breach of the charter party. In addition, the losses were deemed to be too remote from any breach of the charter party.

However, with regards to the third alternative claim the arbitrators found evidence that the information that M/V Baleares would arrive late caused a "hype" of 50 USD/mt in the market. As the LPG market was very small and transparent the delayed supply of a quantity of 30,000 mt had become known to the traders soon and had caused a price increase.

With respect to remoteness the arbitrators held that since the LPG market was very small a shipowner ought to have had at least some market knowledge and knowledge about the patterns of the market. Therefore, they did not find the loss to be too remote. They found the owners to be in breach of the provision to proceed with reasonable dispatch to the load port and awarded USD 1,425,000, being the product of 50 USD/mt and the cargo of 28,500 mt (30,000 less 5%).

### 4.3 The Ulyanovsk (1990)

Another case where a shipowner was held responsible for its charterer's trading losses is *The Ulyanovsk*<sup>77</sup>. In this case the vessel was chartered under an ASBATANKVOY to load 30,000 metric tons of gas oil at Skikda, Algeria for discharge in Mediterranean ports. The vessel arrived at Skikda on 06 December at 1000 hrs and the charterers gave written orders not to tender notice of readiness and not to present the ship for berthing until they would instruct so. The vessel nevertheless tendered NOR and commenced loading on 07 December. Therefore, the bills of lading were dated 07 December as well. 07 December was the date when the spot price of gas oil was calculated and apparently the market was falling. The price the charterers had to pay was the one at the bill of lading date. The charterers argued that they would have paid less had the Master followed their instructions and delayed berthing and NOR tendering. Eventually, in arbitration the charterers were awarded USD 865,571 plus interest for breach of contract. The appeal was dismissed.

### 4.4 The Rio Claro (1987)

A shipping case where the charterer's trading losses were found to be too remote to be recoverable is *The Rio Claro*<sup>78</sup>. The charter party was for the carriage of 55,000 metric tons of crude oil from Ras Shukeir, Egypt to Europe. The charterers and the sellers of the crude oil had an agreement according to which the charterers had to pay the official government selling price. The charter party contained a provision which obliged the vessel to sail from her previous port in Greece no later than 22 November. In breach of this provision the vessel departed from Greece only on 26 November and as a consequence thereof, once the ship arrived in Egypt, a government-ordered price increase had taken place. This price increase of 2 USD per barrel had been announced in the market but the owners apparently were not aware of it. Therefore, the charterers who intended to buy the crude oil had to pay the increased price. They claimed the price difference from the owners. The arbitrators held that the losses were too remote to be recoverable, albeit with regards to causation the Tri-

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<sup>77</sup> *Novorossisk Shipping Co. of the USSR v Neopetro Co. Ltd. (The Ulyanovsk)* [1990] 1 Lloyd's Rep. 425

<sup>78</sup> *Transworld Oil v North Bay Shipping Corp. (The Rio Claro)* [1987] 2 Lloyd's Rep. 173

bunal confirmed that the late departure from Greece led to the loss. The High Court on appeal upheld the Tribunal's award. It did not evaluate further on the issue of causation but rather discussed remoteness. In support of the award, Staughton J stated:

Any tanker owner would have known that there was a great probability that a charterer would be an oil trader buying and selling the cargo for profit. Price movements in a commodity such as crude oil are to be expected. It is not unlikely that the late arrival of a vessel may have adverse consequences on the sale or purchase contract concerning the cargo. The loss in this case was not the result of a change in market price, although such a change may have occurred. It was the result of the terms of the charterers' purchase contract, which were not known to the owners.

#### **4.5 Conclusion**

From these three cases it becomes clear that shipowners may easily become liable for their charterer's trading losses. Also, these losses can get very extensive if they concern, for example, price increases which incurred due to the shipowner's breach of contract, as in *The Baleares*. The considerations regarding remoteness of damage are particularly stunning because they are not necessarily in conformity with the two limbs test in *Hadley v Baxendale*. In *The Baleares* and *The Ulyanovsk* the shipowners were held liable for very remote losses which arose due to special circumstances they had no knowledge of at the time of contract. Thus, these losses would have fallen outside the scope of the two limbs test in *Hadley v Baxendale* and would have been deemed to be too remote to be recoverable had the test been applied. Interestingly, in *The Baleares* there was no reference to the rules on remoteness in *Hadley v Baxendale* at all. A probable reason is that *The Baleares* and *The Ulyanovsk* concern the oil and gas trade. From the reasonings of these cases it seems like at the time the cases were decided the oil and gas market was very small. The judges had argued that the market is small and transparent and that a shipowner who is engaged in the transport of oil and gas ought to know about the typical trade patterns and the charterer's further contractual commitments, even if they are not communicated to the shipowner. Consequently, the rules on remoteness possibly would be applied a little more in the shipowner's favor in trades other than oil and gas; trades with more market players



and less transparency. Nevertheless, the above cases were chosen as examples in order to exemplify consequential losses a shipowner can be held responsible for, even if they seem very remote.

## **5 Exemption Clauses for Consequential Loss in Charter Parties**

### **5.1 Introduction**

Exemption clauses for consequential losses may also be included in charter parties. As it was seen in chapter 3.4, clauses exempting liability for consequential damages are commonly used in many industries. However, they are not as common in charter parties, although consequential losses can become very extensive, as the example cases in chapter 4 have proven. Nevertheless, there are a few standard charter parties which do contain an exemption clause for consequential damages. This chapter is going to focus on exemption clauses in charter parties and how they have been construed under English law. In particular, the emphasis is going to be on BIMCO's TOWCON, SUPPLYTIME 1989 and 2005 and HEAVYCON 2008. There is little authority dealing with the exemption clauses in the aforementioned charter parties. Therefore, general contract law principles need to be applied in order to interpret these clauses.

### **5.2 TOWCON**

TOWCON is the BIMCO-recommended international ocean towage contract for lumpsum towage agreements. Clause 18(3) of TOWCON excludes liability for, inter alia, consequential damages and is worded as follows:

Save for the provisions of Clauses 11<sup>79</sup>, 12<sup>80</sup>, 13<sup>81</sup> and 16<sup>82</sup> neither the Tug owner nor the Hirer shall be liable to the other party for loss of profit, loss of use, loss of

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<sup>79</sup> *Permits and Certification*

<sup>80</sup> *Tow-worthiness of the Tow*

<sup>81</sup> *Seaworthiness of the Tug*

<sup>82</sup> *Cancellation and Withdrawal*

production or any other indirect or consequential damage for any reason whatsoever.

This clause has been considered by the High Court in *Ease Faith Ltd. v Leonis Marine Management Ltd. & Cloudfree Shipmanagement*<sup>83</sup>. *Ease Faith* agreed with the tug owner *Leonis* on a TOWCON form that *Leonis* would use their best endeavors to tow a bulk carrier from Cristobal, Panama, to Zhangjiagang, China<sup>84</sup> where the vessel was to be sold. Since *Leonis* did not own tugs, it entered into a further TOWCON with *Cloudfree Shipmanagement Ltd.* *Ease Faith* claimed that, in breach of the TOWCON, the tug did not proceed with utmost dispatch and therefore the arrival at Zhangjiagang was delayed. As a consequence of the delays, *Ease Faith* claimed additional escort and pilot charges that they incurred amounting to about USD 22,200. In addition, they claimed that the purchasers of the towed bulk carrier paid less for the vessel, their loss amounting to about USD 102,000. Lastly, they claimed loss of interest due to the delayed sale of the vessel to the buyers. *Leonis* counterclaimed from their subcontractor *Cloudfree*.

The question arose whether *Ease Faith* were prevented from claiming the losses due to clause 18(3) of the TOWCON. *Leonis* and *Cloudfree* argued that *Ease Faith*'s claim was for loss of profits which would be excluded by clause 18(3). *Ease Faith* argued that their claim is not characterized as one for loss of profits and even if it was, clause 18(3) would only exclude lost profits if they were indirect, while their claim was for direct loss of profits. Andrew Smith J held at paragraph 142:

In construing the expression "loss of profit" in clause 18(3), it seems to me significant (i) that the expression, being in an exclusion clause, is to be interpreted contra proferentem<sup>85</sup> that is to say without imposing a strained meaning upon the words, the

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<sup>83</sup> [2006] EWHC 232 (Comm)

<sup>84</sup> Eventually the towage commenced in Balboa, Panama instead of Cristobal

<sup>85</sup> For more information regarding the principle of contra proferentem, see for example Guenter Treitel, *The Law of Contract* (12th edn, Sweet & Maxwell) para 7-015

clause is to be interpreted in the event of ambiguity restrictively against the party seeking to rely upon it on the facts of the particular case; (ii) that clause 18(3) is a clause in a standard form agreement that is directed to excluding liability of both the hirer and the tugowner; and (iii) that the clause excludes liability for loss of use and loss of production as well as liability for loss of profit, and that the expression “loss of profit” is to be interpreted as being *eiusdem generis*.

At paragraph 143 he continued:

I interpret the term “loss of profit” as referring to loss of profits generated by future use of the tug or the tow by the towowner or the hirer as the case might be. It seems to be that these losses are similar in kind to loss of use or loss of production and are naturally connoted by the phrase “loss of profit” when read in its context.

At paragraph 144 he stated that:

(...) there are few, if any, losses suffered by a commercial concern that could not be described as amounting to or producing a reduction in the profits, or loss of profit, in this very general sense, for the concern as a whole and for a particular venture or part of the business.

He continues in the same paragraph by interpreting the term “loss of profit” in clause 18(3) to mean loss of productive use of the tug respectively the tow. The losses claimed, on the other hand, are rather for a reduction in price than for a loss of profit. In interpreting whether the clause only includes indirect loss of profits Andrew Smith J refers to Clarke J’s interpretation of the term in the unreported decision *Alexander G Tsavlis & Sons Maritime Co. v OSA Marine Ltd. (The Herdentor)* of 19 January 1996. Clarke J interpreted clause 18(3) to encompassing only indirect losses. This was because of the word “other” in “or any other indirect or consequential damage”. Thus, due to the word “other” Andrew Smith J came to the conclusion that clause 18(3) only excluded indirect losses of profit. Eventually, he concluded that the losses claimed by *Ease Faith* fell outside the exception in

clause 18(3) because they are of direct and not indirect nature. Therefore, *Ease Faith's* claim succeeded.

### 5.3 SUPPLYTIME 1989

BIMCO's SUPPLYTIME 89 is a time charter party for offshore service vessels. Clause 12 deals with liabilities and indemnities and sub-clauses (a) and (b) provide for the knock-for-knock regime of this charter party. Clause 12(c) is the exclusion clause for consequential damages and reads as follows:

Neither party shall be liable to the other for, and each party hereby agrees to protect, defend and indemnify the other against, any consequential damages whatsoever arising out of or in connection with the performance or non-performance of this Charter Party, including, but not limited to, loss of use, loss of profits, shut-in or loss of production and cost of insurance.

This clause was tested in arbitration in London<sup>86</sup>. The time charterers of a diving support vessel claimed deficiencies in the maintenance and condition as well as misrepresentations by the owners. The charterers used the vessel in a salvage operation. The charterers claimed that the owners were in breach of clause 3 of SUPPLYTIME 89 ("Condition of Vessel") because the vessel was not in the condition stated by the owners, ie properly equipped, fully maintained and manned by experienced personnel. The damages allegedly incurred due to the breach were for the costs of the salvage operation which were higher than planned because the vessel was not in proper condition. These costs were mostly for additional days' hire for other vessels and equipment.

With regards to clause 12(c) the charterers argued that their claims would fall under the first limb of the rule in *Hadley v Baxendale* and thus outside of the protection of the clause. Clause 12(c), however, exempted the parties only from consequential damages. The Tribunal held:

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<sup>86</sup> Lloyd's Maritime Law Newsletter 585 of 18 April 2002

(...) the majority of the damages claimed related to the loss of use of other equipment rented by the charterers and of personnel connected therewith. Even if those would not fall under the first rule in *Hadley v Baxendale* (which could not be decided without evidence) still in any event they would be excluded by the words "loss of use" in clause 12(c). Certain of the damages claimed related to the hire or purchase of equipment to substitute for items alleged not to be working, and those might possibly be recoverable as direct losses.

From the reasoning of the Tribunal it becomes clear that clause 12(c) of SUPPLYTIME 89 most likely does not cover losses which are of direct nature. Owing to this, Andrew Iyer<sup>87</sup>, at paragraph 37, suggests that if the parties to a SUPPLYTIME 89 wish to extend the scope of the exemption clause to direct losses, including direct losses of profit, they should amend the wording so that "direct" losses are particularly mentioned as being excluded. However, it should also be kept in mind that arbitration awards do not have a high degree of authority so that the Tribunal's view can easily be revised by a court of law.

#### **5.4 SUPPLYTIME 2005**

In the SUPPLYTIME 2005 version clause 12(c) in SUPPLYTIME 89 has been revised and is clause 14(c) in the 2005 form. It reads as follows:

Neither party shall be liable to the other for any consequential damages whatsoever arising out of or in connection with the performance or non-performance of this Charter Party, and each party shall protect, defend and indemnify the other from and against all such claims from any member of its Group as defined in Clause 14(a).

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<sup>87</sup> Andrew Iyer, 'Consequential Losses in Offshore Contracts' (2008) <[www.standardclub.com/docs/Consequentiallossesinoffshorecontracts-4.pdf](http://www.standardclub.com/docs/Consequentiallossesinoffshorecontracts-4.pdf)> accessed 28 July 2013

‘Consequential damages’ shall include, but not be limited to, loss of use, loss of profits, shut-in or loss of production and cost of insurance, whether or not foreseeable at the date of this Charter Party.

The most striking change is the definition of “consequential damages” in the second part of the clause, and thereby the term “whether or not foreseeable at the date of the Charter Party”. BIMCO’s Explanatory Notes<sup>88</sup> which compare the 1989 with the 2005 SUPPLYTIME version and give comments as to the reasons for the changes do not give any advice with respect to the second part of the clause. Clause 14 (clause 12 in the 1989 version) is about liabilities and indemnities and contains, among other provisions, the knock-for-knock regime of this charter party. The Explanatory Notes say very generally about clause 14 (respectively clause 12 in the 1989 version)

This Clause is recognised as being at the very core of SUPPLYTIME and amendments have only been made where it was considered essential to improve the clarity of the provisions or to reflect changes in commercial practice.

With respect to clause 14(c) (clause 12(c) in the 1989 version) the Explanatory Notes say the following:

Clause 14(c) concerns performance claims under the charter party and a mutual obligation for each party to defend the other if a claim for which the other party is liable is claimed from the non-liable party. The obligation is extended both to claims under knock-for-knock and performance claims under the Charter Party. The wording of the previous Clause 14(c) was slightly vague and it is felt that the new wording expresses the intentions more clearly.

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<sup>88</sup> BIMCO, ‘Explanatory Notes SUPPLYTIME 2005’

<[https://www.bimco.org/~media/Chartering/Document\\_Samples/Time\\_Charter\\_Parties/Explanatory\\_Notes\\_SUPPLYTIME\\_2005.ashx](https://www.bimco.org/~media/Chartering/Document_Samples/Time_Charter_Parties/Explanatory_Notes_SUPPLYTIME_2005.ashx)> accessed 01 September 2013

BIMCO's Legal and Contractual Affairs Officer Anna Wollin Ellevsen advised that the consequential loss clause in SUPPLYTIME 89 did not function well because its phrasing and construction were not adequate. It was drafted based on consequential loss provisions used by oil and gas majors in their logistic contracts.<sup>89</sup> However, the exemption clause in SUPPLYTIME 2005 was not satisfactory, either, which is why BIMCO drafted new consequential loss clauses in 2008 in the revised TOWCON<sup>90</sup> and TOWHIRE<sup>91</sup> contracts. According to BIMCO's Legal and Contractual Affairs Officer<sup>92</sup> the wording of the exemption clauses in TOWCON 2008 and TOWHIRE 2008 were influenced by the following decisions: *Hadley v Baxendale*<sup>93</sup>, *Alexander G Tsavlis & Sons Maritime Co. v OSA Marine Ltd. (The Herdentor)*<sup>94</sup>, *Ease Faith Ltd. v Leonis Marine Management Ltd. & Cloudfree Shipmanagement*<sup>95</sup> and *Ferryways NV v Associated British Ports*<sup>96</sup>.

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<sup>89</sup> E-mail from Anna Wollin Ellevsen to author (14 October 2013)

<sup>90</sup> Clause 25 of TOWCON 2008 deals with liabilities and indemnities. Clause 25(c) reads: Save for the provisions of Clauses 17, (Permits & Certification); 18, (Tow-worthiness of the Tow); 19, (Seaworthiness of the Tug); 22 (Termination by the Hirer) and 23 (Termination by the Tugowner), 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, and whether or not the same is due to negligence or any other fault on the part of either party, their servants or agents, or

(ii) any consequential loss or damage for any reason whatsoever, whether or not the same is due to any breach of contract, negligence or any other fault on the part of either party, their servants or agents.

<sup>91</sup> TOWHIRE is BIMCO's standard International Ocean Towage Agreement (Daily Hire). Clause 23(c) in TOWHIRE 2008 is the same as clause 25(c) in TOWCON 2008 except for the references to other clauses. Here the clause numbers are different.

<sup>92</sup> E-mail from Anna Wollin Ellevsen to author (14 October 2013)

<sup>93</sup> (1854) 9 Exch 341

<sup>94</sup> Unreported, see ch 5.2

<sup>95</sup> [2006] EWHC 232 (Comm), see ch 5.2

<sup>96</sup> [2008] 1 Lloyds Rep 639

This sheds some light to the question of what the wordings of the clauses are based on and what they were influenced by. However, the intention BIMCO had in mind by adding the words “whether or not foreseeable” in the consequential loss clause in SUPPLYTIME 2005 is not exactly clear since they do not give a specific explanation. Andrew Iyer<sup>97</sup> suggests, at paragraph 40, that the clause might cover both losses falling under the first and second limb of the rule in *Hadley v Baxendale*. However, since this has not been tested in court, he recommends<sup>98</sup> parties wishing to extend the scope of the clause to direct and indirect losses to particularly mention this in the clause. Robert Gay<sup>99</sup>, on the other hand, believes that the second part of clause 12(c) will not have the effect to include losses falling under the first limb of the rule in *Hadley v Baxendale*. Rather, in his opinion case law suggests that only losses falling under the second limb will be covered by this clause.

Unlike in TOWCON, neither SUPPLYTIME charter party makes reference to “indirect” losses in its exemption clause. Rather, clause 12(c) and 14(c) only name consequential losses and not indirect losses as being excluded. Except for *Millar’s Machinery v David Way*<sup>100</sup> and *Croudace v Cawoods*<sup>101</sup>, all of the exemption clauses interpreted in the cases presented in chapter 3.4 did not only exclude liability for consequential damages but also for indirect losses. At the same time, the interpretations of the exemption clause in these cases often lead to the comparison with the two limbs test in *Hadley v Baxendale*. Accordingly, only damages which fell under the second limb of the rule were covered by the exemption clause while direct losses, namely those falling under the first limb, were recoverable as they fell outside the protection of the exemption clause. However, this is not an

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<sup>97</sup> Andrew Iyer, ‘Consequential Losses in Offshore Contracts’ (2008) <[www.standard-club.com/docs/Consequentiallossesinoffshorecontracts-4.pdf](http://www.standard-club.com/docs/Consequentiallossesinoffshorecontracts-4.pdf)> accessed 28 July 2013

<sup>98</sup> At para 41

<sup>99</sup> Robert Gay, ‘Any Consequential Damages Whatsoever’ (2010) para 11-24 <[www.shippinglbc.com/content/uploads/members\\_documents/offshore\\_contracts\\_1.pdf](http://www.shippinglbc.com/content/uploads/members_documents/offshore_contracts_1.pdf)> accessed 08 September 2013

<sup>100</sup> See ch 3.4.2

<sup>101</sup> See ch 3.4.3



established principle and for instance McGregor claims that consequential losses may be direct losses as well.<sup>102</sup>

Furthermore, it should be recalled that the rules on remoteness require a degree of predictability in order for a loss to be recoverable. This means that losses can only be recovered if they were somehow foreseeable to be likely to incur as a consequence of a particular breach of contract at the time the contract was entered into. So it is also possible that BIMCO, when drafting clause 14(c) of SUPPLYTIME 2005, wanted to make sure that the clause is interpreted without reference to the two limbs test in *Hadley v Baxendale* but rather with McGregor's approach.

Moreover, the addition of the words "whether or not foreseeable at the date of this charter party" suggests that the clause shall not be interpreted according to the usual rules on remoteness since they require losses to have been somewhat foreseeable in order to be recoverable. Rather, it appears like the clause shall ensure that liability for the named losses, ie loss of use, loss of profits, shut-in or loss of production and cost of insurance is excluded in any event, regardless of the established rules on remoteness. This shall also extend to other consequential losses which are not listed in clause 14(c). This interpretation goes in line with the idea of the knock-for-knock regime of this type of charter party which is that each party is financially responsible for its own claims and does not hold the other party liable, irrespective of fault. With clause 14(c) it is ensured that the parties do not keep each other responsible for consequential losses so that the principle of the knock-for-knock regime is extended to consequential losses as well.

## **5.5 HEAVYCON 2007**

HEAVYCON is BIMCO's standard charter party for heavy and voluminous cargoes. It has been revised in 2007. Clause 22 provides for the knock-for-knock regime of this charter party and clause 23 is the exemption clause for consequential losses. The wording is identi-

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<sup>102</sup> See further on McGregor's views in ch 3.5.2

cal to clause 14(c) of SUPPLYTIME 2005 and therefore the same analysis as in 5.4 applies.

## 5.6 Conclusion

Besides an exemption clause for consequential loss, TOWCON, TOWHIRE, SUPPLYTIME and HEAVYCON 2007 all provide for a knock-for-knock regime. The aim of a knock-for-knock provision is clear allocation of losses and avoidance of costs and time-consuming disputes. The principle is that each party covers its own loss and damage, regardless of which party has caused it. Accordingly, it can be assumed that the exemptions for consequential loss were included in these charter parties in order to enhance clarity on cost allocation.

The question arises why there is no such risk allocation in other voyage or time charter parties. It is certainly not useful to have a knock-for-knock regime in charter parties covering ordinary cargo trade because this would lead to unbalanced risk and cost allocations while it is useful in offshore contracts because of the high risks involved in the oil and gas sector.

However, it might make sense to have an exclusion clause for consequential loss in other charter parties as well. The example cases in chapter 4 have shown the dimensions consequential losses can achieve. Furthermore, shipowners were held liable for very remote losses and in the cases mentioned, no insurance would have covered the costs the shipowner was held liable for. Consequently, a shipowner may have an interest in including an exemption clause in the charter party. However, there is no tradition in ordinary cargo trade to have such a clause. Shipowners would likely benefit most from such an exemption clause since they might be able to exclude liability for losses like in *The Balears*. There are only scarce situations in which a shipowner might incur consequential loss. An example would be a loss like in *The Achilles*. However, the charterer is more likely to suffer consequential loss due to a shipowner's breach of contract, especially with regards to delays.

Thus, the knock-for-knock regime and an exemption for consequential loss are very appropriate in the offshore oil and gas sector. This is due to the very high risks involved that

would be inequitable for a shipowner to be exposed to. However, in ordinary cargo trade it is mostly the charterers who would not wish to have an exemption for consequential loss in the charter party because this would deprive them of the possibility to recover certain losses incurred due to the shipowner's breach of contract. Moreover, it should be kept in mind that cargo trade is subject to mandatory legislation, for example the Hague/Hague-Visby-Rules, when a bill of lading is issued. These rules provide for liability limitations and liability exclusions for damages arising out of certain perils, for example fire. It would be too extensive to discuss these caps on liability and exclusions of liability in this work, however, the fact that there is a risk allocation and liability limitation and exclusion system in the cargo trade is possibly another reason why exemption clauses for consequential loss are usually not found in charter parties covering ordinary cargo trade.

## **6 Conclusion**

Regardless of the type of industry, a clause exempting liability for consequential loss always has the same purpose: It serves to allocating risks and thereby providing the parties with a degree of certainty with respect to what financial consequences they have to expect in case of a breach of contract. The cases analyzed in this work have shown that there is neither a unanimous definition of consequential loss nor a unique approach to interpretation of exemption clauses adopted by the courts.

Throughout this work twelve cases which consider the interpretation of clauses exempting liability for consequential or indirect loss have been discussed. From these cases the following findings with regards to interpretation can be summarized:

1. The term "consequential loss" can be interpreted to mean losses that fall under the second limb of the rule in *Hadley v Baxendale*. These are losses that arise not directly but due to special circumstances from the breach of contract.
2. Since this rule is not an established principle it can at least be stated that consequential loss is more remote or less immediate than direct loss. Direct loss is covered by the first limb of the rule in *Hadley v Baxendale* and stems naturally from the breach of contract, from the ordinary course of things.

3. An exemption clause worded like in *Markerstudy Insurance*, ie liability is excluded for “(...) *indirect or consequential loss (including but not limited to loss of goodwill, loss of business, (...))*” is interpreted to mean that the types of loss listed in parentheses are mere examples of indirect or consequential loss but are not a free-standing category of loss. This means that the types of loss in parentheses cannot be direct loss that shall be excluded.
4. Types of loss like lost profits and increased production costs can be direct losses if they are sufficiently proximate.
5. An exemption clause worded like in TOWCON, ie liability is excluded for “(...) *loss of profit, loss of use, loss of production or any other indirect or consequential damage for any reason whatsoever.*” means that loss of profit, loss of use and loss of production are only excluded if they are of indirect or consequential nature. If they are direct they are not embraced by the exemption clause.

Accordingly, if the parties to a contract wish to have an exemption clause in their contract, it should be worded based on their individual needs. Nevertheless, a few general summarizing remarks with regards to exemption clauses for consequential loss can be made. First of all, the analyzed case law has shown that usage of the all-encompassing term “indirect or consequential” loss in an exemption clause is too ambiguous. With an exemption for “indirect or consequential loss” the parties to a contract have little certainty about which losses are actually excluded. Rather, it is advisable to list the particular losses that shall be excluded, for example loss of profits, loss of business, and loss of use. Furthermore, the parties to a contract need to decide whether they wish to exclude these losses only if they are of consequential nature or also when they are direct, thus a natural result of the breach of contract.

If the parties wish to exclude consequential loss for loss of profit, loss of business and loss of use, a clause can be worded as follows: “[*The parties*] do not assume liability for any indirect or consequential loss such as loss of profit, loss of business and loss of use arising out of or in connection with the performance or non-performance of this contract.”

If the parties would like to exclude the aforementioned losses regardless of whether they are direct or consequential they may word their exemption clause along the following lines: *“[The parties] do not assume liability for loss of profit, loss of business and loss of use, whether direct, indirect or consequential, arising out of or in connection with the performance or non-performance of this contract.”*

The exemption clause in TOWCON has been tested in two High Court decisions where it was held that it excluded only indirect but not direct loss of profit, loss of use, and loss of production. The exemption clause in SUPPLYTIME 1989 was tested in arbitration but the exemption clauses in SUPPLYTIME 2005, HEAVYCON 2007, TOWCON 2008 and TOWHIRE 2008 have not been tested in court at all. Accordingly, the strength and clarity of these clauses is not certain, especially with respect to the fact that the courts have so far not agreed on a unanimous interpretation of consequential loss in the context of exemption clauses.

Eventually, it can be stated that an exemption clause needs to be worded as precise as possible in order to provide the parties with the highest degree of certainty. The particularities of the respective business are the decisive factors in determining which losses shall be excluded and whether it is sufficient to exclude indirect or consequential loss or to exclude direct losses, too. Nevertheless, it must be kept in mind that there is no ultimate definition of consequential loss in the context of exemption clauses but it is possible that in future cases the courts will lay down a firmer interpretation.

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