

Excluding liability for consequential loss and loss of profits

In construction and engineering projects, the financial consequences of a breach of contract may be considerable – in the worst case an employer may suffer extensive losses, including loss of profits, loss of business and loss of revenue. Construction and engineering contracts often therefore contain clauses excluding the contractor's liability for consequential losses. Some also specifically exclude liability for loss of profits. However, without careful drafting, such clauses may not always achieve what the contractor intends.

What is "consequential loss"?

For an exclusion clause to be effective it must clearly identify what losses are being excluded. However, all too often parties draft a clause excluding liability for "consequential loss"¹ without properly understanding what the term means or considering what losses are intended to be excluded from the party's liability.

The term "consequential loss" is often used in everyday language as shorthand for a broad category of losses including loss of profit, loss of opportunity, loss of goodwill and so on. However, the legal meaning of the term may be quite different.

English law has traditionally allowed recovery of two categories of loss caused by a breach of contract:

- losses that are the direct and natural consequence of the breach (for example, the cost of remedying defects); and
- losses which do not arise in the natural course of events but which were nevertheless within the contemplation of the parties to the contract at the time that the contract was entered into (for example, lost profits, if both parties were aware at the time of signing the contract that a delay to the completion of a new factory building would cause the owner to lose a major manufacturing contract).

Under English law, the term "direct loss" will broadly cover losses falling within the first category, and "indirect losses" will cover losses falling within the second category. Sadly, there is no comprehensive list of what losses will always be considered to be "direct" or "consequential". Each case will be decided on the specific facts. In practice, it can be difficult to determine whether a loss falls within the first or second category.

Given the uncertainties in predicting what the term "consequential loss" may mean in any given circumstance, if a party intends that it should not be liable for certain types of losses, then the exclusion clause should list, in clear terms, exactly which types of losses are to be excluded.

Excluding liability for loss of profits

When it comes to considering liability for loss of profits, English courts have held that loss of profits could fall within either the first or the second category of losses.

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¹ Under English law, terms such as "consequential loss", "indirect loss", "special loss", "incidental loss" are considered to mean broadly the same thing.

For example, in a case where defects caused an explosion at a methanol plant, the Court found that the reconstruction costs, loss of profits and wasted overheads all arose as a direct result of the breach of contract². In such circumstances, therefore, a clause excluding liability for "indirect and consequential loss" would not have the effect of excluding the contractor's liability for those specific reconstruction costs, loss of profits and wasted overheads.

Therefore, if the intention is to exclude liability for all types of loss of profits, the clause must specifically say this.

On this point, it is important to note that there is a risk that a clause that excludes liability for "*consequential losses, including loss of profit*" would not have the effect of excluding liability for all loss of profits. The word "including" may be interpreted as meaning that only liability for consequential loss of profits is to be excluded, with the result that the contractor would still be liable for any loss of profits that the employer suffered as a direct and natural consequence of the contractor's breach of contract³.

Drafting exclusion clauses

If a contractor intends to exclude liability for certain losses, it should ensure that the clause expressly lists the categories of losses that are to be excluded. Take as an example, Clause 17.6 of the FIDIC Silver Book:

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

The equivalent exclusion clause at Clause 30.2 of the ENAA forms⁴ states:

*"The Contractor shall in no event be liable to the Owner by way of indemnity or by reason of any breach of the Contract or in tort or otherwise for loss of use of the Plant or any part thereof or for loss of production, loss of profit or loss of any contract, **or** for any indirect, special or consequential loss or damage that may be suffered by the Owner in connection with the Contract."*

The highlighted word "**or**" in both clauses has the effect of ensuring that liability for both direct and indirect loss of profits (and/or loss of use, contract, production etc), is excluded.

Conclusion

A clause excluding liability for "indirect and consequential losses" is of limited value to a contractor.

Before drafting or negotiating the exclusion clause, it is important to be clear as to what losses are to be excluded from the contractor's liability and then list those categories of losses in the exclusion clause. If the intention is to exclude liability for both direct and indirect losses of the categories listed, ensure that the clause is drafted to exclude liability for "*all consequential losses, **and** [loss of profit/use/revenue etc]*".

² *Deepak Fertilisers v ICI Chemicals* (1999).

³ The concern arises from the approach taken by the Court of Appeal to a specifically worded exclusion clause in *University of Keele v Price Waterhouse* (2004).

⁴ ENAA Model Form International Contract for Power Plant Construction 1996, and ENAA Model Form International Contract for Process Plant Construction 1992.

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