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CONTRACTS UPDATE: CLARIFICATION ON THE MEANING OF "CONSEQUENTIAL LOSSES"

The term "consequential loss" is often included by parties in their contracts with the intention of framing limitation of liability clauses excluding liability for financial loss. There are a number of Court of Appeal cases that have found, on a number of occasions that consequential loss means only such loss as is recoverable under the second limb of the rule in *Hadley v Baxendale, that is, losses* that result from special circumstances, which will only be recoverable if the other party knows of those circumstances.

In a recent case, the High Court in England has considered the meaning of the contractual term, "consequential or special losses, damages or expenses" in the context of a limitation of liability clause contained within a commercial contract (*Star Polaris LLC v HHIC-PHIL INC* [2016] EWHC 2941 (Comm)). The decision appears to indicate a more flexible approach, with courts perhaps being more willing to look more particularly at the contract in which such terms are contained, and the context in which they are used, and to interpret the relevant terms accordingly. The court's decision in the *Star Polaris* case demonstrates that the same words, when used in different contracts and in different commercial circumstances, can be imbued with different meanings.

The facts

In the *Star Polaris* case, the claimant buyer had purchased a ship which was built by the defendant shipbuilder under a contract in variance of the standard form ship-building contract. The contract included a wide assurance given by the defendant which guaranteed the ship for 12 months against all defects due to defective materials, design error, construction miscalculation and/or poor workmanship. A number of exclusions applied to this guarantee including, inter alia, perils of the sea, wilful neglect and normal wear and tear. The contract also provided that the defendant would have "no liability or responsibility whatsoever or howsoever arising for or in connection with any consequential or special losses, damages or expenses unless otherwise stated herein" (the "**exclusion clause**").

Several months after the claimant took delivery of the ship, the ship suffered a serious engine failure and had to be towed to a dockyard for repairs. The Claimant contended that the engine failure was caused by the defendant's breaches of contract and claimed compensation for the cost of repairs to the ship, towage fees, agency fees, survey fees and off-hire, as well as for diminution in the value of the ship.

At arbitration, the tribunal found that the claimant's claims above and beyond the cost of repair of physical damage were excluded under the contract because they were

"consequential or special losses, damages or expenses" which were excluded pursuant to the exclusion clause. The tribunal found that the word "consequential" was used by the parties in a "cause-and-effect" sense, meaning "following as a result or consequence". The tribunal's view, therefore, was that the defendant only undertook to repair or replace defects falling within the guarantee, meaning that all other financial consequences were to fall on the claimant. Other than the cost of repair and replacement, the remaining losses were losses that were consequential in the "cause-and-effect" sense, and so, on a true construction of the contract, were not recoverable.

On appeal, the High Court stated that the contract provided a complete code for the determination of liability, confirmed in the contract by the following words: "*The guarantees contained as hereinabove in this article replace and exclude any other liability, guarantee, warranty and/or condition imposed or implied by statute, common law, custom or otherwise on the part of the [defendant] by reason of the construction and sale of the vessel for and to the [claimant].*" The court's view was that it was "*not therefore a question of simply determining what liability is excluded, but ascertaining what liability is undertaken.*" This was regarded by the court as being of "fundamental importance" in considering the ambit of the contract.

In respect of the claimant's argument that the wording used in the exclusion clause in the contract fell within the second limb of Hadley v Baxendale, the court noted that even where the words indirect or consequential appear to have acquired a well-recognised meaning, the scope of such wording must depend on the true construction of the clause in question. Furthermore, where a party sought to protect himself from liability for losses otherwise recoverable by law for breach of contract, that party "must do so by clear and unambiguous language". In *Star Polis*, the court stated that in this case the "*well-recognised meaning [from Hadley v Baxendale] was not the intended meaning of the parties*".

The court confirmed that "*any particular clause fell to be construed on its own wording in the context of the particular agreement as a whole and its particular factual background.*" The court found that the only positive obligations assumed by the defendant under the guarantee were for the repair and replacement of defects and physical damage caused by such defects. This was the extent of the liability which had been undertaken by the defendant under the contract, and as such these obligations, according to the court, were "*exhaustive and nothing else is recoverable above and beyond that*".

CONCLUSIONS AND LESSONS

- Parties should not take comfort from previous interpretations of specific contractual terms and simply assume that the courts will apply the same interpretation again. Rather, parties should understand that the courts have discretion to consider each contract as a whole and in its own context.

- The *Star Polis* case is a useful reminder that liability limitation wording in contracts must be drafted clearly and must be unambiguous. When drafting and negotiating contracts in the first place, parties should therefore ensure that the contract is drafted clearly and

that the parties understand the contractual effect of the liability limitation wording which is agreed between them.

- Parties may wish to consider setting out an extensive and exhaustive "code of damages", stating in clear language what is covered. Given that limitation of liability provisions are usually only tested when they are most required, parties seeking to rely on limiting provisions may wish to take a little extra time at the outset identifying the losses that may flow from the contract and setting out those losses or liabilities that they are prepared to accept and those which they intend to exclude.

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