Excluding Consequential Loss - Does it Matter if You've Been Naughty or Nice?

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Attempts to exclude or limit liability for consequential loss have given rise to considerable litigation, across industries. As two recent decisions in the energy sector have illustrated, adopting apparently wide-ranging and legalistic phraseology in such clauses may not have the desired result for the party seeking to limit its exposure.

It remains paramount to say clearly and precisely in the contract what losses are excluded. While English contract law generally allows the parties great freedom to allocate risk and liabilities, exclusion and limitation clauses are construed narrowly such that a more balanced, fairer result might be achieved.

In this article, we revisit the basic principles governing damages for breach of contract and liability for financial loss in particular, before reviewing *Transocean v Providence* (2014),a dispute under a contract for the hire of a drilling rig, and *Scottish Power v BP Exploration Operating Company* (2015), a case arising under a gas sales agreement relating to the Andrew Field in the North Sea.

A case of two limbs

When reviewing damages for breach of contract, one usually starts about 160 years ago with the famous decision in *Hadley v Baxendale* [1854] EWHC Exch J70. The general rule is that damages are meant to compensate the innocent party for the bargain it lost, by putting it into the position it would have been if the contract had been performed. Damages for breach of contract can be awarded for any loss that falls within the contemplation of the parties. *Hadley v Baxendale* hasdivided recoverable losses into two categories, or limbs: direct and indirect loss.

Direct losses

As a matter of law, all losses that occur as a direct, ordinary or natural consequence of the breach - or, to put it differently, which arise in the usual course of things - are deemed to be reasonably foreseeable, and within the contemplation of the parties. That means the parties are objectively taken to have foreseen that particular loss at the time of entering into the contract, whether or not they actually did. These 'direct losses' are often referred to as coming within the first limb of the rule in *Hadley v Baxendale*, and they generally have to be 'not unlikely' (and hence reasonably foreseeable) to be recoverable (see *Koufos v C Czarnikow Ltd (The Heron II)* [1969] 1 AC 350).

Special or indirect losses

But there may be other, more unusual and generally more extensive, losses that do not fall within the first limb, but for which damages are nevertheless recoverable because these losses are foreseeable in the particular circumstances of the case, and hence not 'too remote'. That, however, requires that the special circumstances which give rise to these losses were in fact brought within the contemplation of the parties, for instance by having been communicated, or otherwise become apparent, at the time of contracting.

The example that is often used to illustrate this 'second limb' of *Hadley v Baxendale* is found in *Victoria Laundry (Windsor) v Newman Industries* [1949] 2 K.B. 528. The defendant seriously delayed delivery of a new boiler for the claimant's laundry business. As a result, the claimant lost considerable business, including an especially lucrative Government contract. The Court of Appeal held that the loss of profit under the Government contract was not recoverable. The defendant had neither been told about this deal, nor could he reasonably have expected to have known about it, when signing the agreement. The other party has to be made aware of any special circumstances at the time of entering into the contract. That is the temporal cut off point (as reaffirmed, for instance, by the House of Lords in *Jackson v Royal Bank of Scotland* [2005] UKHL 3). So, things would have been different if Victoria Laundry had said 'You do realise we might lose the deal of the century if you are very late with this boiler' when signing the agreement - but not if they had only remembered to mention the profitable contract the following week.

Economic or financial loss can be within either limb

Economic or financial loss is often equated with the notion of 'consequential loss'. Over the years, there have been a number of decisions, including by the Court of Appeal, which have held that under English law 'consequential loss' however means 'indirect loss' falling within the second limb of *Hadley v Baxendale* (see for instance *Croudace Construction v Cawoods* 8 BLR 20, and *British Sugar Plc v Nei Power Projects Ltd* [1997] EWCA Civ 2438). Referring to 'consequential loss' in an exclusion clause does not, therefore, shed any light on what kind of economic or financial loss, or loss of profit or revenue, has been excluded. All these types of monetary losses can either be direct, or indirect ('consequential'). Taking the *Victoria Laundry* case as an example, damages would be recoverable for all loss of profit that would follow in the ordinary course of business, by the laundry not being able to serve customers without the delayed boiler. Certainly, loss of profit that could have been earned as a result of the performance of the contract itself is likely to be direct loss (see *Hotel Services Ltd v Hilton International Hotels (UK) Ltd* [1997] EWCA Civ 1822).

The decision in *McCain Foods (GB) Ltd v Eco-Tec (Europe) Ltd* [2011] EWHC 66 further illustrates that liability for direct financial loss (within the first limb) can be significant. McCain operated a waste water treatment system, which produced biogas. It then bought a system from Eco-Tec that was meant to generate electricity from biogas. The system was, however, unfit for its purpose and could not be installed and commissioned. The contract excluded any liability for "*indirect, special, incidental and consequential damages*". Nonetheless, the Court found that McCain could recover for all of the following financial loss as a direct consequence of the breach:

- the cost of buying and installing a working replacement system to generate electricity from biogas;
- the cost of buying electricity instead of generating it from the time that the system should have been operational;
- loss of revenue from operating the system, in particular revenue that could have been earned by selling Certificates of Renewable Energy Production;
- the additional cost of employing contractors, site mangers and health and safety personnel while the system was being worked on; and
- the cost of personnel already employed whose time was taken up by the defects, the cost of expert analysis and testing, and the cost of additional equipment and further construction work purchased from Eco-Tec and others in an attempt to get the system to work.

All of this was found to be loss that resulted in the ordinary course from the failure to provide a working system.

A new consideration: the 'assumption of responsibility' for particular losses

The law as to what damages were recoverable for breach of contract had changed little since *Hadley v Baxendale* until 2008, when the House of Lords decided *Transfield Shipping Inc v Mercator Shipping Inc* [2008] UKHL 48. In *Transfield*, their Lordships considered the policy reasons behind the law on damages, identifying an assumption of responsibility (by the contracting parties) as the basis on which liability for losses of a particular kind was imposed. *Transfield* concerned the late redelivery of a vessel by the charterers to the owners. The owners were forced to renegotiate the subsequent charter, since the vessel could not be tendered on the agreed date. The market was exceptionally volatile during that period, and the renegotiations led to a much lower rate than had previously been agreed, based on the prevailing market price at that time (which seemed to have fallen by 20 per cent over a few days).

An arbitral tribunal found that all the losses incurred by the owners as a consequence of having to renegotiate the subsequent fixture had been reasonably foreseeable. The House of Lords, however, disagreed, and in so doing reformulated the test for remoteness. Lord Hoffman in particular stressed that damages are awarded not purely based on what losses a reasonable person could foresee, but only for those losses for which the contracting parties would have 'assumed responsibility' (reflecting the consensual nature of contracts). A significant factor in this case was the very widespread acceptance or practice in the shipping industry that charterers did not assume the full risk of the owner losing out on subsequent fixtures if they delayed redelivery: charterers instead only expected to pay the difference between their charter rate and the market rate (if any) during the period of delay. It followed that the entire loss arising under the less favourable follow-on fixture was not loss for which the charterers could be deemed to have assumed responsibility at the time of contracting.

Transfield Shipping gave rise to some debate, not least because the five Law Lords expressed themselves in different ways, and not all of them seemed to expressly endorse the 'assumption of responsibility' test. The Court of Appeal provided some guidance two years later, confirming that assumption of responsibility was now part of the law, in *Supershield Ltd v Siemens Building Technologies FE Ltd* [2010] EWCA Civ 7. Toulson LJ explained that while *Hadley v Baxendale* remained the standard rule:

> *"… Transfield Shipping [is] authority that there may be cases where the court, on examining the contract and the commercial background, decides that the standard approach would not reflect the expectation or intention reasonably to be imputed to the parties."*

This introduces a further element of judicial discretion into the recoverability of damages. Whether the parties may have contemplated a particular loss when they entered into the agreement is no longer the end of the matter: one may now also ask whether it is commercially reasonable that they should be taken to have 'accepted the risk'.

In *Transfield* itself, Lord Hope pointed out that a party to a contract who wishes to protect itself from a particular risk can always draw the other party's attention to it - thus bringing it within their contemplation. If the other party does not wish to assume responsibility for that risk, they can then ask for an appropriate exclusion. His Lordship noted that the charterer in *Transfield* could not be expected to assume responsibility for something they did not control, and knew nothing about, and for which he could not therefore quantify the exposure. It was not enough for the charterer "*… to know in general and on open-ended terms that there is likely to be a follow-on fixture*." On this approach, the owners could never have provided the relevant information at the time of entering into the original charter, because they too had no idea by how much they would lose out subsequently when the market fell and they had to accept a lower rate. This does seem to go against previous decisions to the effect that it was sufficient that the type of the loss was foreseeable, but not the extent of the loss (*Hill v Ashington Piggeries* [1969] 3 All ER 1496), the detail of it, or manner in which it came about (*Parsons (H) (Livestock) Ltd v Uttley, Ingham & Co Ltd* [1978] QB 791).

Unlikely loss may be recoverable if preventing it falls within a contractual duty

One way of explaining *Transfield* is to treat it as being concerned with an exceptionally large loss, caused by the highly volatile and unpredictable market at the time, that was simply unforeseeable by either owner or charter and could never have been brought within the contemplation of the parties. However, subsequent decisions have shown that *Transfield* did introduce a new legal principle, and was not just limited to its particular facts. In *Supershield v Siemens,* applyingthe 'assumption of responsibility' test had the opposite result and led to a party being liable for damages for loss that was unforeseeable, or unlikely. The Court of Appeal held that:

> *"… logically the same principle may have an inclusionary effect. If, on the proper analysis of the contract against its commercial background, the loss was within the scope of the duty, it cannot be regarded as too remote, even if it would not have occurred in ordinary circumstances."*

The case concerned a flood in an office building caused by a sprinkler system. A ball valve and drains were both aimed at preventing such a flood. The evidence showed that this was an unlikely, possibly unprecedented, failure of both these protection measures. The Court of Appeal noted that such unlikely loss would still be recoverable if it came within a contractual duty to prevent it from occurring. In complex projects, designers may well incorporate several redundant protection or 'failsafe' measures, but it would be no excuse to say that the circumstances in which they all failed were unlikely - if it was the duty of the designers to protect against flooding, fire or the like. The Court of Appeal held that:

> *"If … the unlikely happens, it should be no answer for one of them to say that the occurrence was unlikely, when it was that party's responsibility to see that it did not occur. … the reason for having a number of precautionary measures is for them to serve as a mutual back up, and it would be a perverse result if the greater the number of precautionary measures, the less the legal remedy available to the victim in the case of multiple failures."*

Liability for economic or financial loss will also be assessed under the above principles. What is more, contractual provisions seeking to preclude or limit liability for any types of losses that are recoverable in principle will be treated as 'exclusion clauses', and they will be construed strictly, as can be seen from the two recent decisions in *Transocean v Providence* and *Scottish Power v BP Exploration Operating Company*.

***Transocean Drilling UK Ltd v Providence Resources Plc* [2014] EWHC 4260**

The decision of the Commercial Court in *Transocean Drilling UK Ltd v Providence Resources Plc* [2014] EWHC 4260 (Comm) shows that contractors relying on apparently comprehensively drafted exclusion and limitation clauses in industry standard form contracts may nonetheless be in for an unwelcome surprise if they fail to perform to the contractual standard.

Transocean had agreed to provide a semi-submersible drilling rig, the 'Artic III' to Providence, under a drilling contract based on the LOGIC form. The Artic III was to drill an appraisal well in the Barryroe Field, located in the Celtic Sea south of Cork, Ireland. Transocean's remuneration provisions in the drilling contract provided for a daily operating rate of US$ 250,000, with slightly lower rates for waiting on instructions and repair (the latter being US$ 245,000 per day).

Drilling was delayed for 46 days, between 18 December 2011 and 2 February 2012, due to problems caused by the blow-out preventer ("**BOP**") stack. While the BOP problems prevented drilling, Providence incurred substantial marine spread costs - being the daily rates payable to all the other contractors providing support services for the drilling operations (Providence was responsible for well logging, testing, cementing, mud engineering and logging, geological services, casings, directional drilling, diving and ROVs). Providence's spread losses came to about US$ 10 million. Transocean commenced the litigation, claiming unpaid sums under the drilling including approximately US$ 7.6 million calculated based on day rates for the period of the delays. Providence resisted that claim, and counterclaimed for its spread losses.

Standing in Transocean's shoes at the outset of the proceedings, one might have felt fairly confident because (certainly at first blush) the LOGIC form appears to favour the drilling contractor. Transocean's first argument was that Providence had to pay the applicable day rates (based on the particular activity of the rig on any given day) irrespective of whether the BOP problems were Transocean's fault under the contract. It pointed to a number of specified rates (all close to US$ 250,000 per day) that were said to be payable even if the rig happened to be doing something that could be the result of Transocean's negligence - examples being the 'redrill rate' or the 'fishing rate' (which applies when some object has fallen into the well bore and has to be retrieved).

Counsel for Transocean argued that a risk allocation that was not fault-based made sense: failures affect drilling operations are often technically complex, and can require lengthy investigations to determine the cause of the failure, and whether any breaches of the drilling contractor's obligations or standards of performance might be involved. Transocean said that the simple allocation of risk provided for by its reading of the remuneration clause as a complete code gave everyone clarity and certainty: one could not expect expensive drilling operations to grind to a halt, with support services and third parties all having been mobilised, while the parties went off to the Commercial Court or an arbitral tribunal to find out who was to blame.

Mr Justice Popplewell disagreed. He referred to three principles or propositions of English contract law that could only be displaced by very clear words in the contract:

- firstly, that a party to a contract should not be able to take advantage of, or benefit from, its own breach (found in *Alghussein Establishment v Eton College* [1988] 1 WLR 587);
- secondly, that exemption clauses which could be taken on their face to refer only to non-negligent breaches will be so construed, unless a very clear intention to extend their scope to negligence is apparent; and

- thirdly, that when construing a contract "… *one starts with the presumption that neither party intends to abandon any remedies for its breach arising by operation of law, and clear express words must be used in order to rebut this presumption*." (*Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1974] AC 689).

Following on from the third principle, it is a fundamental right, recognised by the common law, that a buyer does not have to pay for defective, or deficient, goods and services - this is the venerable remedy of 'abatement' which ultimately allowed Providence to defeat Transocean's claim.

The judge also relied on a previous Court of Appeal decision, in *Sonat Offshore SA v Amerada Hess* [1998] 1 Lloyd's Rep 145, concerning another rig, which had suffered a fire due to lack of maintenance by the owner. The Court of Appeal held that that contract, too, did not amount to an agreement that 'something would be paid for nothing', and that an obligation to pay during a period when no services were performed would only be implied absent any other reasonable alternative. The manner in which Parker LJ phrased the question in *Sonat* illustrates how English contract law approaches the issue:

> *"[The main issue] is whether the company, having been deprived of all benefit from the rig for one month due to the negligence and breach of contract of the contractor, is nevertheless obliged to pay, during that period, the equipment breakdown rate without any right of reduction, set-off or counterclaim. Unless the terms of the agreement are such as to exclude such a right, the company is clearly not so obliged."*

It can be seen that it is the purchaser's <u>right</u> not to pay when no services are being performed, and it is that right that needs to be given up, or excluded. A clause merely referring to rates being payable in circumstances that might or might not involve a period without services or delays due to negligence may very well fall short of having that exclusionary effect. This is even more likely the result where the remuneration provision in question is expressed to be in return for the provision of services, rather than being expressed purely by reference to periods of time elapsed under the contract.

Popplewell J also expressly stated that a rig contract was no different from any other contract for goods and services. Drilling contractors or operators sometimes rely on the inherent risk in offshore exploration works, or the 'knock-for-knock' indemnities which provide that each party is responsible for loss of or damage to their own equipment and personnel, even though that may have been caused by the negligence of the other party, stating that these contracts are 'special'. They are not, and fall to be construed just like an ordinary agreement for the hire of a car:

> *"… hirers of a rig are no more likely than any other person who contracts for the provision of goods and services to agree to pay something for nothing, particularly if the failure to perform is due to the negligence or default of the payee ."*

One key provision that Transocean was relying on was the repair rate clause:

> *"3.9 Repair Rate $245,000*
>
> *Except as otherwise provided, the Repair Rate will apply in the event of any failure of [Transocean's] equipment (including without limitation, non-routine inspection, repair and replacement which results in shutdown of operations under this CONTRACT …"*

The judge found that the reference to the rate being payable regardless of "*any failure*" of Transocean's equipment did not mean that Providence had agreed to pay Transocean when the rig was not performing the required work because of a breach by Transocean. "*Any failure*" really meant 'a failure for which Transocean was not responsible under the contract'. Indeed, if Transocean were right, Transocean would have to be paid if it deliberately sabotaged the rig and then claimed the repair rate, and that, the judge found, simply could not have been intended.

The judge went on to find that the BOP problems had been caused by breaches of contract, on the part of Transocean, largely by reason of poor maintenance. At the time, Transocean had carried out an internal investigation into the causes of the relevant failures, on the understanding that Providence would be supplied with a copy of the resulting report. Unhappily for Transocean, initial drafts that identified lack of proper maintenance of BOP elements as the root cause were 'doctored', and any references to inadequate maintenance were removed, before Providence was given the report. Popplewell J noted that this amounted to deception which "*reflect[ed] no credit on Transocean's senior management*".

Was Providence's spread loss excluded by virtue of being 'Consequential Loss'?

Transocean's breach in turn entitled Providence to rely on abatement as a defence to Transocean's claim for payment. Of course, Providence also wanted to recover the US$ 10 million in spread costs that it had incurred. The obstacle to overcome in that endeavour was Clause 20, which excluded liability for 'Consequential Loss' (as defined) and provided for knock-for-knock indemnities as regards such losses affecting the property, equipment and so on of Providence and Transocean respectively.

Breaking the clause down into its constituent parts, the first limb of the definition of Consequential Loss referred to "*(i) any indirect or consequential loss or damages under English law*." This was a reference to the second limb in *Hadley Baxendale*, meaning losses that did not result in the ordinary course of things as a direct consequence of the breach, and which would only be recoverable if the special circumstances that gave rise to the relevant loss were within the contemplation of the parties. The parties were agreed that Providence's spread losses were direct losses, and hence not caught under this heading.

The next part of the definition of Consequential Loss sought to widen the concept to certain direct losses (under the first limb), and was so widely drafted that it might - on a cursory read - be thought to capture Providence's spread loss:

> *"(ii) to the extent not covered by (i) above, loss or deferment of production, loss of product, loss of use (including, without limitation, loss of use or the cost of use of property, equipment, materials and services including without limitation, those provided by contractors or subcontractors of every tier or by third parties), loss of business and business interruption, loss of revenue (which for the avoidance of doubt shall not include payments due to [Transocean] by way of remuneration under this CONTRACT), loss of profit or anticipated profit, loss and/or deferral of drilling rights and/or loss, restriction or forfeiture of licence, concession or field interests …"*

The above was the critical wording on which Transocean's case rested. Once again, the Court applied the principle in *Gilbert-Ash*, that commercial parties (even those entering into a rig contract, with all the attendant risk and exposure) were unlikely to give up their basic rights at common law - and the right to recover damages for direct losses flowing from a breach of contract is such an entitlement.

The judge held that sub-paragraph (ii):

> *"must be construed in the context of it being a specifically defined incursion into the territory of the first limb of Hadley v Baxendale, and should therefore be approached by treating the enumerated types of loss as incremental incursions into that territory, construed narrowly to limit the scope to specific categories narrowly defined rather than a widespread redefinition of excluded loss."*

The fact that there was a mutual indemnity regime (knock-for-knock) in the contract did not displace that assumption, as the Court of Appeal had noted in *EE Caledonia Ltd v Orbit Valve Co Europe Plc* [1994] 1 WLR 1515.

Stacking the odds further against Transocean was the "*contra proferentem*" rule of contractual interpretation, which provides that exclusion clauses are to be interpreted narrowly and against the party seeking to rely on them.

Returning to the contract wording, eight different types of loss were enumerated in the clause:

(i) loss or deferment of production;

(i) loss of product;

(iii) loss of use (including, without limitation, loss of use or the cost of use of property, equipment, materials and services including without limitation, those provided by contractors or subcontractors of every tier or by third parties);

(iv) loss of business and business interruption;

(v) loss of revenue;

(vi) loss of profit or anticipated profit;

(vii) loss/deferral of drilling rights; and

(viii) loss/restriction/forfeiture of licence, concession or field interests.

The Court found that all these types of loss were concerned with losing income or revenue that would have been generated but for the breach. Spread costs fall into a different category - as they are costs incurred for (usually) plant and equipment that is on hire, but cannot be 'used' effectively.

Transocean however argued that the spread costs claim was for 'loss of use of the property, equipment, materials and services provided by contractors, subcontractors and third parties', and so squarely within the excluded category of loss at item (iii) above. The judge did not accept that. He concluded that 'loss of use', when looked at together with its contractual neighbours (all concerned with loss of revenue), was more naturally to be read as "*… connoting the loss of expected profit or benefit to be derived from the use of property or equipment.*"

The Court further noted that:

> *"Cost of use … is an example given within the parenthesis of a loss of use. It covers the cost of hiring in equipment or services, or replacing property the benefit of which has been lost, in order to mitigate the loss of benefit. It has no application to the spread costs where the costs are for equipment and services which were provided. Providence did not lose the use of that equipment or those services, which remained available to it, which is why Providence incurred wasted expenditure in paying for them."*

Finally, and picking up the thread running through the judgment, Popplewell J noted that if Transocean's reading were right, then the exclusion would cover each and every kind of loss that Providence might conceivably suffer. English law does not easily accept such a result in a commercial contract. As the House of Lords noted in *Suisse Atlantique Societe d'Armement Maritime SA v NV Rotterdamsche Kolen Centrale* [1967] 1 AC 361

> *"… the parties cannot, in a contract, have contemplated that the clause should have so wide an ambit as in effect to deprive one party's stipulations of all contractual force; to do so would be to reduce the contract to a mere declaration of intent."*

Transocean lost because the judge felt that the drafting in the LOGIC form, whilst certainly effusive, was not actually wide enough to cover the spread cost. It is at least plausible, if not likely, that a contrary result was intended by the drafter, and that industry players had been operating on the assumption that such a result had been achieved. Not so.

***Scottish Power UK Plc v BP Exploration Operating Company Ltd* [2015] EWHC 2658**

In late September 2015, the Commercial Court had a further opportunity to construe an exclusion clause concerned with consequential loss, in a long term gas sales agreement. Scottish Power had contracted to buy natural gas under a series of virtually identical agreements with the owners of the Andrew Field in the North Sea. The Andrew owners had shut down production for about three and half years, from May 2011 to December 2014. The shutdown was required to allow for works to tie in the Andrew facilities with the neighbouring Kinnoull Field. It was also, however, a breach of the gas sales agreements, as the Commercial Court found.

During the shutdown period, Scottish Power had continued to make daily nominations for quantities of gas (even though nothing would be delivered), and had gone into the market to purchase replacement gas, at a price greater than that which would have applied under the gas sales agreements with the Andrew owners. These agreements also provided for a particular contractual regime or remedy, whereby the Andrew owners were required to deliver an equivalent quantity of so-called Default Gas at a lower price, once production and deliveries had resumed, to make up for the shortfall.

Scottish Power claimed damages based on the additional cost of having to buy replacement gas, whilst giving credit for the value of Default Gas that would be provided by the sellers under the contract.

Mr Justice Leggatt decided a number of preliminary issues, one being whether such a claim for damages would be excluded by Article 4.6 of the agreements, which provided:

> *"Save as expressly provided elsewhere in this Agreement, neither Party shall be liable to the other Party for any loss of use, profits, contracts, production or revenue or for business interruption howsoever caused and even where the same is caused by the negligence or breach of duty of the other Party."*

The Andrew owners claimed that this precluded a claim for the additional cost incurred in procuring replacement gas in the open market. Leggatt J gave this argument short shrift, describing it as an untenable contention. As in *Transocean*, he had in mind the principle in *Gilbert-Ash* - that parties do not easily give up the entitlement or remedy they have at law (though in the end found it unnecessary to even bring it into play). Damages for a failure to deliver in a contract for the sale of goods would in the ordinary course be assessed under the Sale of Goods Act 1979. Section 51(2) provides that the measure of damages is "*the estimated loss directly and naturally resulting, in the ordinary course of events, from the seller's breach of contract*", while subsection (3) goes on to provide that if there is an available market, the loss is taken to be the difference between the contract price and the market price for the goods at the time the goods were meant to have been delivered.

Article 4.6 did not seek to draw a distinction between direct and indirect loss, and did not make reference to 'consequential loss'. Instead, it referred to types of loss. One may assume that the intention behind the clause was to exclude all losses that were of the relevant types listed out, regardless of whether they were direct, or indirect. The loss that Scottish Power sought to recover was certainly 'direct', as is apparent from the Sale of Goods Act, but was it of the requisite (excluded) type? The judgment gives a brief commentary on how these types were construed by the Court:

(i) Loss of profits concerns the situation where Scottish Power was unable to resell gas at a profit. Loss of revenue was similar.

(ii) Loss of contracts applied to any agreements that might be cancelled, or opportunities to enter into new agreements that Scottish Power lost, because it did not have the gas promised by the Andrew owners.

(iii) Loss of production referred to any inability to produce other products - such as electricity - because there was no gas from the Andrew Field, but it was not aimed at the gas that was sold itself. Business interruption was similar in nature.

(iv) Finally, loss of use was also concerned with a secondary loss, which might result from Scottish Power being unable to use the gas it had contracted for in its own business.

All these losses were of a kind that went beyond the basic measure, and were concerned with future benefits that could be earned if the contract had been performed (so indirect losses), not with the cost of replacing the very same goods that had been promised under the contract.

The Andrew owners however also raised another point, arguing that losses incurred in mitigating an excluded type of loss were themselves also excluded. Hence, since Scottish Power could not have claimed for losses relating to other contracts (such as loss of profits) that it intended to fulfill with the (more expensive) replacement gas, then (it was submitted) neither could Scottish Power claim for the additional cost of purchasing that replacement gas that was going to be used to perform those other contracts.

Leggatt J held that there was no principle of law that required a loss incurred in mitigating an excluded loss as also being (itself) excluded. He noted that if this argument worked, one would not find it very difficult to exclude a great many (direct) losses, because they would have been incurred in the attempt to mitigate other (indirect) losses. But this relationship of mitigation did not mean that a clause that was concerned with indirect losses could, as if by magic, also apply to direct losses.

The Andrew owners relied on a judgment by Rix J in *BHP Petroleum Ltd v British Steel plc* [1999] 2 All ER (Comm) 544, where he said that:

> *"… in many instances losses are claimed on the basis of mitigation; a greater loss of one kind is avoided by the incurring of a lesser loss of another kind in mitigation of the first. In my judgment, such mitigated loss must be regarded as though it was, for the purpose of [the exclusion clause in question] a loss of the kind sought to be avoided …"*

BHP v British Steel concerned a failed pipeline that had to be replaced. The contract provided that British Steel was not liable for "*loss of production*". Leggatt J explained that BHP had been allowed to recover the cost of replacing the pipeline itself (a direct loss, like Scottish Power's cost of replacing the gas), whilst it had been unable to recover certain additional costs in producing oil and gas that had resulted from the pipeline failure: that was 'loss of production', even though these costs may have been incurred in order to mitigate the loss, by (for example) restoring production sooner rather than later.

The Sole Remedies Clause

So far, so good for Scottish Power: the loss incurred in buying the more expensive replacement gas was not excluded. However, the gas sales agreement also included a 'sole remedy' provision that referred to the supply of Default Gas at the agreed, reduced price as being the only redress for the buyer. Article 16.6, the key clause, stated:

> *"The delivery of Natural Gas at the Default Gas Price and the payment of the sums due in accordance with the provisions of Clause 16.4 shall be in full satisfaction and discharge of all rights, remedies and claims howsoever arising whether in contract or in tort or otherwise in law on the part of the Buyer against the Seller in respect of underdeliveries by the Seller under this Agreement, and save for the rights and remedies set out in Clauses 16.1 to 16.5 (inclusive) and any claims arising pursuant thereto, the Buyer shall have no right or remedy and shall not be entitled to make any claims in respect of any such underdelivery."*

Leggatt J upheld that clause (widely drafted as it was) as excluding Scottish Power's claim for anything other than delivery of Default Gas at the agreed discount, since Scottish Power's claim was in 'respect of underdeliveries'. The gas sales agreement required Scottish Power to continue to make daily nominations even during the period of the shutdown, and any shortfall in deliveries against nominations were in effect 'underdeliveries' (and hence within Article 16.6). The judge found it did not matter that this clause could enable the Andrew field owners to breach the contract deliberately, by selling gas to someone other than Scottish Power at a higher price, and intentionally causing an underdelivery.

The judgment provides a neat reminder that an award of damages or compensation under English contract law is not concerned with punishing the contract-breaker for any fault or wrongdoing:

> *"It is a basic principle that the object of an award of damages for breach of contract is to compensate the claimant for loss sustained as a result of the defendant's breach and not to deprive the defendant of any gain. Moreover, this principle applies and the measure of damages is the same irrespective of whether the breach was deliberate, careless or entirely innocent. I see no reason to infer that the contractual remedy with which the remedy of damages is replaced by Article 16 was intended to operate differently."*

One limit in the application of Article 16, however, would have been a claim for damages for repudiatory breach (i.e. a serious breach that went to the root of the bargain between the parties). If the sellers deliberately decided to shut down the production facilities for good, or without any kind of commitment to resume production at some point in the future, that breach might entitle Scottish Power to terminate the contract by accepting the Andrew field owners' repudiatory breach. A sole remedies clause could not then save the sellers from a claim for damages based on the cost of obtaining all gas that should have been delivered over the remaining term of the contract, at the market price.

Discussion

It has to be recalled that when it comes to the interpretation of contracts, each case will depend on the words used in the particular contract, interpreted in the usual way (so objectively and in the light of the factual background and the commercial purpose of the transaction). Strictly speaking, it is possible that expressions such as 'consequential loss', 'loss of use' or 'loss of production' might be given different interpretations where they appear in different agreements. In practice, however, this is unlikely: for one thing, decisions interpreting these particular expressions are often cited - as *Transocean* was cited in *Scottish Power*.

Following the decisions of Popplewell J and Leggatt J (and further authorities they both rely on in their judgments), one can identify certain points or approaches to construction which are likely to feature in subsequent cases dealing with similar clauses:

- High-value, complex agreements in the energy industry (be they rig hire or drilling contracts or long term gas sales agreements) are not exempt from basic principles of construction: no commercial party is easily presumed to have agreed to pay something for nothing, and basic rights and remedies at common law must be expressly excluded.
- The reported decisions suggest that expressions such as 'loss of use', 'cost of use' or 'loss of production' may well be taken to refer to indirect losses, within the second limb of *Hadley v Baxendale*, and, to the extent that a clause tries to make inroads into the recoverability of direct losses that fall within the first limb of *Hadley v Baxendale*, such a provision will be construed narrowly. This is illustrated by *Transocean v Providence*.
- It may serve parties well to consider abandoning some of these phrases often found in exclusion or limitation clauses, and say more plainly what they mean by reference to the particular transaction: if everyone agrees that the cost of keeping support services and logistics (including the marine spread) mobilised while a drilling is non-productive, then say precisely that in the contract.
- Although clear words are needed to exclude the ordinary remedies that the law provides, it is still necessary to keep a cool head and not be influenced by perceived 'bad behaviour' (or deliberate breaches) by any party. A contract breaker is generally free to make gains, provided that the innocent party is compensated for its (recoverable) losses.

In conclusion, if the allocation of risks or liabilities is really intended to favour one party in particular, then you need to be very careful to spell this out, and (ideally) explain why this has been agreed in the contractual wording. A judge or arbitrator, who comes to the agreement cold some years later, might otherwise apply the principles of construction discussed in this article to achieve a different, more balanced, result.

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