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Excluding “direct” loss of profit

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The recent High Court case of *Markerstudy Insurance Company Limited v. Endsleigh Insurance Services Limited* [2010] EWHC 281 (Comm) is a timely reminder that parties need to be careful when drafting clauses excluding consequential losses.

Under English law, losses for breach of contract are recoverable if the two-limbed test of remoteness in *Hadley v. Baxendale* is satisfied. The first limb allows losses arising naturally, according to the normal course of things, from the breach of contract. The second allows losses which may reasonably be supposed to have been in the contemplation of the parties at the time they made the contract, as a probable result of the breach.

Losses under the first limb are referred to as ‘direct’ losses. Losses under the second are referred to as ‘indirect’ or ‘consequential’ losses.

Confusion can arise in exclusion clauses which exclude indirect or consequential loss, and also give examples of types of excluded loss, such as loss of profit. Under English law, loss of profit can be either a direct or an indirect loss, depending on whether the specific loss satisfies the first or second limb of *Hadley v. Baxendale*. The question can therefore arise whether the parties intended to exclude all loss of profit, or just indirect loss of profit.

This was the question facing Mr. Justice Steel in *Markerstudy v. Endsleigh*. He referred to the judgment of Rix J in *BHP v. British Steel* [1999] 2 Lloyd’s Rep 583 holding that a clause excluding “loss of production, loss of profits, loss of business **or any other indirect losses or consequential damages**” should be interpreted as if it read “**or indirect losses or consequential damages of any other kind**” (emphasis added), since in Rix J’s view it was sufficiently clear that the parties had intended to exclude all liability for loss of production etc., as well as any other indirect or consequential liabilities, but “*may have been in error to permit the inference that [loss of production, etc.] are examples of indirect or consequential loss.*”

The first clause in *Markerstudy* excluded: “*any indirect loss 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).*” Steel J construed this as only excluding indirect or consequential losses. Direct losses of the listed categories were therefore recoverable. He said that the words “*including but not limited to*” strongly indicated that the categories were a type of indirect loss.

Steel J’s decision in relation to the second clause was more surprising.

This clause excluded “*any indirect or consequential loss or loss of profit or loss of business*”. Steel J acknowledged that the argument that “*the specified forms of loss are freestanding and ... inclusive of both direct and indirect loss*” was on “*somewhat firmer ground*”. But he preferred the argument that “*the introductory phrase ‘any direct or indirect loss’ governs and defines the scope of the specified forms of loss*” and concluded that only indirect loss of profit or business was excluded.

However, this conclusion was notwithstanding that there would not appear to be anything in the clause which suggested that the parties intended loss of profit etc. to be examples of consequential loss.

This case highlights the importance of leaving no possibility for doubt in such clauses. If the parties intend to exclude all loss of profit etc., whether direct or indirect/consequential, the clause should expressly say so.

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