THE OIL & GAS
“CONTRACTING COMPASS”

9 – POINTING THE COMPASS TOWARD CONSEQUENTIAL LOSS
INTRODUCTION

Welcome to the ninth white paper of the “Contracting Compass” seminar series – a Brodies oil and gas initiative offering insight on issues of English law relevant to oil and gas contracts. The “Contracting Compass” is designed to provide a continuing commentary on English law by highlighting key clauses and focusing on particular points of law and practice most relevant to each clause in a way which heightens awareness of the whole of the landscape of a contract.

As shown in the image below, we have changed the directional points of the compass.

The compass is labelled in this way because navigating the landscape of a contract requires knowledge of the law, an understanding of how language should be drafted in light of the law, and recognition of how that language will work in practice – whether it relates to contract performance, the ultimate commercial concern of payment or, if a breach has occurred, damages or other remedies.

For each seminar in the series, we will present a white paper dedicated to a single topic. This paper covers the topic of Consequential Loss. We hope you find this paper to be of use and if you are interested in attending any of our accompanying seminar series, please do not hesitate to contact us directly.

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BACKGROUND

WHAT IS “CONSEQUENTIAL LOSS”?

A simple question; however, one that has spawned widespread debate in the oil and gas sector in recent years - among practitioners, academics, the courts and contracting parties. So why is the question so widely debated - in part, because the answer is so uncertain, and such uncertainty can carry significant commercial consequences?

The industry has historically recognised that there are particular types of losses (typically labelled “consequential”) which may arise under commercial contracts throughout the supply chain and, if they do arise, they carry significant risks – a risk of being uninsurable and/or unquantifiable, and also a risk of financial burden being vastly disproportionate to a party’s commercial reward. For these reasons, parties to an oil and gas contract have frequently agreed contractual terms tailored to protect each of them from liability for the other party’s “consequential loss” – most frequently in the form of mutual indemnity or an exclusion of liability.

The importance of the label “consequential loss” is therefore clear; however, the meaning of the label is not so certain. In this paper, we will consider why so much uncertainty exists and explore constructive steps for understanding this uncertainty, from the perspective of the law, and managing and mitigating the effects of such uncertainty through careful and considered drafting of key provisions of the contract. Toward this end, we will start with a focus on two propositions.

- **Proposition One**: Although “consequential loss” is recognised at law in most jurisdictions we know, with certainty, that when drafting an oil & gas contract relying on the law is not enough.

- **Proposition Two**: If you cannot rely on “consequential loss” at law, we know that you need to define it in the contract and we also know, with certainty, that “it is not easy to define”.

So why are the above two propositions, and the certainties to be drawn from them, so helpful? Because they do, in fact, provide a useful framework for considering the principal question - “what is “consequential loss”?” For this reason, we have structured the remainder of this paper to consider the question in two parts.

**One – “naked language” and its meaning at law is not enough...**

In the first part we will examine, from the perspective of the contract and the law, why “the law is not enough”? In particular, considering circumstances where parties have used the *naked language* of “consequential loss” in a contract without defining it and have thereby relied, to their detriment, upon a “narrow” meaning of the words as recognised at law.

**Two – a blanket of protection beyond the bare words... the right size for recognised risks**

In the second part we will consider, from the same two perspectives, the importance of creating a definition in the contract (i.e. a blanket of protection beyond the bare words); and also focus on practical steps for right sizing the blanket for covering the recognised risks of the parties in each contract. Size matters but so does substance; so we will further consider, not only right sizing the blanket of protection but also getting the content right.
PART 1 – “THE LAW IS NOT ENOUGH?”

“If you want the present to be different from the past, study the past.” Baruch Spinoza

LOOKING AT THE LAW

It is instructive to first reflect on the history of “consequential loss”. Considering “consequential loss” in the present and “why the law is not enough” today is informed by a long line of historical case law. Looking to the past brings a number of seminal cases into sharp focus and we will highlight these throughout the paper. However, it is ironic that so much uncertainty in the law today in respect of such a noteworthy concept actually starts with a single case decided many years ago in the middle of the 19th century - namely, Hadley v. Baxendale, [1854] 9 Ex 34 (“H v B”). The case of the two limbs is, perhaps, one of the most celebrated and influential cases in the world of common law.

Hadley v Baxendale

It all began with a broken crankshaft. A mill, used by Hadley, had become unworkable due to a broken crankshaft in the steam engine. In order to get the mill back up and running, Hadley engaged Pickford & Co (whose senior partner was Baxendale), to transport the crankshaft to the location at which it would be repaired and then subsequently transport it back. Hadley notified that the shaft had to be sent immediately, and Baxendale promised to deliver it the next day.

Despite this promise, and completely unaware that the mill was unworkable without a new shaft, Baxendale returned the repaired crankshaft to Hadley seven days after receiving it. As a result of the delay, Hadley claimed Baxendale’s negligence caused the mill to be inoperable for an additional five days and sought damages to cover the loss of profits and payment of wages. Baxendale’s defence was that such an action was unreasonable as he was unaware that the delayed return of the crankshaft would necessitate the mills closure and thus that the loss of profit failed to satisfy the test of remoteness.

The Court found for the defendant. As Baxendale had not reasonably foreseen the consequences of delay and Hadley had not informed him of them, he was not liable for the mill’s loss of profits.

The importance of this decision is that it sets out the traditional test of remoteness which, in essence, is a test of foreseeability. That is, the loss will only be recoverable if it was in the contemplation of the parties. The knowledge that is taken in to account when assessing what is in the contemplation of the parties comes under two limbs:

1. **Direct losses** - loss that flows naturally from the breach; and

2. **Indirect/Consequential loss** - loss that parties knew, or can reasonably be supposed to have known, at the time of the contract, was likely to flow from a breach.

This narrow interpretation from the courts provides a clear dichotomy between the legal definition and the lay interpretation of “consequential losses”. It is this contrast that has been the cause of many disputes.
Victoria Laundry

In Victoria Laundry (Windsor) Ltd v Newman Industries Ltd, [1949] 2 KB 528; the state of knowledge required to render a defendant liable for losses under limb 1 and/or limb 2 was considered by the Court of Appeal.

The claimant launderers and dyers contracted with an engineering firm, Newman Industries, for the sale of a boiler with a view to expanding their business and fulfil particularly lucrative dyeing contracts. They made Newman Industries aware, by letter, that the boiler would be put to use in the shortest possible time. Delivery of the boiler was to take place on 5th June but the boiler sustained damage when being handled by Newman Industries’ subcontractors and delivery was delayed until 8th November. Victoria Laundry pursued Newman Industries for breach of contract and included in their claim their lost profits in respect of loss of “normal” profits and the loss of the lucrative dyeing contracts as a result of the delayed delivery of the boiler. The trial judge awarded Victoria Laundry some damages but not lost profits on the basis that the special circumstances had not been brought to the attention of Newman Industries in accordance with the requirement of the second limb rule in Hadley v Baxendale.

The Court of Appeal reversed the decision and allowed the appeal. Victoria Laundry were awarded damages, under the limb 1 rule, in respect of the loss of “normal” profits representing the custom they would have benefited from with the additional capacity afforded by the new boiler. The court said Newman Industries could not reasonably contend that they could not foresee such loss as a result of a long delay in delivery. Knowledge was imputed. Victoria Laundry were not awarded damages in respect of the particularly lucrative dyeing contracts of which Newman Industries had no actual knowledge however.

The measure of damages was assessed on the state of Newman Industries knowledge i.e. whether this knowledge was imputed or actual and the two limbs of Hadley v Baxendale were developed accordingly.

Following Victoria Laundry, first limb losses are subject to a “reasonable man” i.e. objective, test of knowledge, “Everyone as a reasonable person is taken to know the ‘ordinary course of things’ and consequently what loss is liable to result from a breach of contract in that ordinary course.” As to second limb losses, the test should be one of the subjective knowledge which the contract-breaker “actually possesses of special circumstances outside the ‘ordinary course of things’”.

![Image of a ship at sunset]

LAW

PAYMENT

DRAFTING

PERFORMANCE
The rules were discussed again by the House of Lords in *The Heron II* HL [1969] 1 AC 350 where the court reaffirmed that parties to a contract are known to each other and have had the opportunity to apportion their liabilities based on their knowledge of the risk. This was contradistinguished from the wider test for remoteness in tort which applies to include loss that is unusual but was nevertheless a possible result of the breach. For a party to contractually agree to accept responsibility for exceptional or unnatural risk would be odd given that the purpose of a contract is to protect oneself from risk that a party can foresee may result from a breach.

By the late 1960s, the evolutionary course for the rules of recovery of loss for breach of contract had gotten thus far:

**Direct losses**: Loss arising naturally out of the breach i.e. in the ordinary course of things. As a reasonable person, the contract-breaking party is taken to know what this loss will be;

and

**Indirect (or consequential) losses**: (in relation to special, abnormal or unusual loss) loss which was within the contemplation of the parties, at the time of the contract was concluded, as the probable result of the breach, with any special circumstances being known to the contract-breaking party.

However, though the theoretical boundary between the two limbs had been well settled by the late 1960s, it is clear from more recent cases that the meaning of the terms “indirect” and “consequential loss”, when used in practice, has not been so settled – i.e. by practitioners, contracting parties and the courts.

Fast forward to the present and the meaning of ‘consequential loss’ was again at the centre of a dispute in the case of *Star Polaris*.

**Star Polaris LLC v HHIC-PHI Inc [2016] EWHC 2941 (Comm).**

Star Polaris LLC (the “Buyer”), entered in to a shipbuilding contract with HHIC-Phil Inc (the “Yard”) for the build and purchase of a bulk carrier, the ‘Star Polaris’ (the “vessel”).

Seven months after the delivery of the vessel, it suffered serious engine failure which required the vessel to be towed to South Korea for repair. The Yard denied all liability for the incident and the Buyer commenced arbitration claiming:

1. the cost of repairs to the vessel
2. the costs caused by the engine failure, including towage fees, agency fees, survey fees; and
3. the diminution in the value of the vessel.

The contract provided that the Yard 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 guarantee was to “replace or exclude any other liability...implied by statute, common law, custom or otherwise”.
The Buyer’s claim centred around the argument that the losses claimed were not excluded as they were all direct, ordinarily foreseeable and, therefore, within ‘limb 1’ of Hadley v Baxendale, and could therefore not be considered “consequential or special losses”.

However, the Tribunal held that the Buyer’s claims (above cost of repairs) were excluded under the contract as they fell within the "consequential or special losses” exclusion. The tribunal noted that the phrase "consequential losses" was not limited to losses or damages which fell within the second limb of Hadley v Baxendale, but instead, went beyond to exclude any losses which were consequential to the direct loss. In other words, those that followed from the initial loss.

On appeal, the High Court agreed with decision of the tribunal concluding that, within the context of this particular contract, the word ‘consequential’ was not used in the traditional legal context (i.e second limb of Hadley v Baxendale), but in a cause and effect sense. Therefore, the damages that followed as a result or consequence of the physical damage were deemed to be ‘consequential’ under the contract.

Some of the commentary on this case can be misleading. It perhaps suggests that the phrase “consequential or indirect” always has a wider meaning than was established by the well-known authorities discussed above. This is not the case. Star Polaris turned on the fact the phrase was part of a guarantee provision that, together with other language in that provision, made it clear that the parties intended to limit the obligations of the shipyard to only the cost of repair following a defect. But for the phrase appearing in that particular clause, the usual modifying effect of the phrase would have presumably limited the excluded losses to limb two losses only.

**LOOKING AT THE CONTRACT**

**From Principles-To-Practice**

Having summarised a spectrum of cases on what “consequential loss” means under English law, the last case, Star Polaris, is a convenient stepping off point for now “looking at the contract” and turning our attention to a few points of practice.

The first point of practice that must be emphasised (in light of the line of cases from Hadley v Baxendale establishing the boundary between the 1st and 2nd limbs) is that when the words “indirect” or “consequential” appear in a contract (and appear on their own, undefined), the courts have typically construed them very narrowly – i.e. interpreted as only covering the types of losses recognised as arising under the 2nd limb.

In its most basic form, an exclusion clause addressing indirect or consequential loss could be drafted as simply as:

“the seller shall not be liable to the buyer for any indirect or consequential loss arising from the contract”.

In fact, many of the English law cases summarised above in the “looking at the law” section have considered a contract with language in such basic form – and each of them concluded that “consequential” or “indirect” in its naked form means only 2nd limb losses. From a practical perspective, what is the importance of this conclusion?

When a breach of an oil and gas contract occurs, particularly one within the supply chain, the vast majority of damages that will flow from the breach will be direct – i.e. 1st limb losses reasonably foreseeable as naturally
arising from the breach. For example, the courts have consistently concluded that loss of profits (Deepak Fertilizers & Petrochemical Ltd v Davy McKee (UK) London Ltd (1998) CA), loss of revenue, business interruption and loss of product are first limb damages. Therefore, a courts narrow interpretation of the expression “consequential” or “indirect” as only second limb damages will mean that a breaching party relying upon this bare language as a “blanket of protection” will in fact have very little, if any, protection. In other words the breaching party will be exposed to all of the types of damages described above as typically arising from the breach of an oil and gas contract.

There is also a second point of practice that must be emphasised in relation to the meaning of “consequential loss”. Although the courts have been consistent in their understanding of the legal meaning of “consequential” or “indirect”, they have not consistently applied this legal meaning in recent cases.

The Star Polaris case, as referred to above, is a shining example of the importance of the second point of practice. The Court of Appeal’s decision emphasises that language may have a recognised meaning at law, in theory, but that same language may not have the same meaning when used in a contract. When parties are negotiating and agreeing language in a contract, they must recognise that drafting should never occur in a vacuum. A practitioner should always attempt to anticipate any alternative interpretation that words may be given in the context of how and where they are used.

What we can learn from history, from a practical perspective, is therefore two-fold. One, “consequential loss” has a very narrow meaning at law and, if used in an exclusion or indemnity clause, the language is likely to provide little, if any, protection. Two, even if the parties are well aware of the narrow legal meaning and they are content to rely upon it in the contract, it is not certain that the courts will always apply the legal meaning.

Given this uncertainty, a practitioner should always assume that naked language and relying on the law is never enough. And a practitioner should also assume that where the law is deficient in the meaning of “consequential loss”, only a properly considered and drafted definition in the contract can provide a robust and reliable blanket of protection. These assumptions are a logical transition to the second part of this paper – our focus on the importance of defining consequential loss.
PART 2 – DEFINE IT – “CREATING A BLANKET OF PROTECTION BEYOND THE BARE LANGUAGE AND RIGHT SIZING IT FOR THE CONTRACT”

LOOKING AT THE CONTRACT

From Principles-To-Practice

One logical starting point for considering a definition of “consequential loss” is the suite of LOGIC standard forms. The first version of the LOGIC forms in the late 1990s, then published under the auspices of CRINE, included the following definition of “consequential loss”:

“For the purposes of this Clause 20, the expression “Consequential Loss” shall mean indirect losses and/or loss of production, loss of product, loss of use and loss of revenue, profit or anticipated profit.”

Comparing this language to the narrow meaning of “consequential loss”, undefined, how much additional protection does this definition provide? The answer is not very much and we can turn to case law to explain why.

LOOKING AT THE LAW

We are going to depart from the chronological approach adopted in part one and instead behave like a search engine and address the most relevant results first. Broadly, this means looking at cases discussing language which places the general words “consequential” and/or “indirect” before any specific heads of loss i.e. loss of profit, which is a similar structure to the LOGIC language above.

Polypearl Ltd v E.On Energy Solutions Ltd [2014] EWHC 3045 (QB)

The court held that an exclusion clause that read “neither party will be liable to the other for an indirect or consequential loss, (both of which include, without limitation...loss of profit)” was not effective at excluding liability for a direct loss of profit; the words in brackets after the general words being examples of what could be categorised as an indirect loss and not an attempt at including a direct loss in an indirect loss category. The court stated that if the parties had intended to exclude a claim for direct loss of profit, clear language should have been used.

Ferryways NV v Associated British Ports (2008) 1 Lloyds Rep 639

Ferryways was a claim brought by a Belgian ship owner, against an English port owner as a result of the death on board a vessel owned by Ferryways.

The deceased was supervising loading and unloading operations when he was hit by a tugmaster vehicle driven by an employee or subcontractor of the defendant. Sums were paid by the North of England P&I Club (in which the vessel was entered) in respect of the death and the cost of repatriating the body. The claimant, who was the charterer of the vessel, sought to recover the sums from the defendant.
Although this case considered six preliminary issues, for present purposes, we only need to focus on one. Preliminary issue five assessed whether or not the defendant could rely upon the exclusion and limitation provision in the stevedoring contract.

Clause 9 of the Stevedoring contract excluded liability for:

“any loss, damage, costs or expenses of any nature whatsoever incurred or suffered by the Customer which is of an indirect or consequential nature including without limitation the following: (i) loss or deferment of profit; (ii) loss or deferment of revenue; (iii) loss of goodwill; (iv) loss of business; (v) loss or deferment of production or increased costs of production; (vi) the liabilities of the Customer to any other party”.

The defendant submitted that the loss in question (liability to the next of kin of the chief officer) is a ‘liability of the Customer to any other party’ within cause 9(c)(vi) of the stevedoring contract in respect of which the defendant “shall have no liability”.

The claimant submitted that in order that a loss may fall within the type of loss in respect of which liability is excluded the loss must be ‘of an indirect or consequential nature’ as provided by clause 9(c) of the stevedoring contract. Further, that such words have been consistently construed as referring to losses which are other than those which flow directly and naturally from the alleged breach of duty.

Teare J concluded that the listed losses and liabilities were excluded only if they were indirect. In his words:

“The important question therefore is whether the words in clause 9 ‘including without the limitation the following’ indicate clearly that the parties were giving their own definition of indirect or consequential losses so as to include the specified losses even if they are the direct and natural result of the breach in question. In my judgment, those words do not provide the sort of clear indication which is necessary for the defendant’s argument. The parties are merely identifying the type of losses (without limitation) which can fall within the exemption clause so long as the losses meet the prior requirement that they ‘of an indirect or consequential nature.’ Had the parties intended that liability for losses which were the direct and natural result of the breach could be excluded they would have hardly have described such losses as ‘indirect or consequential’.

Following this, it was held that the losses claimed in this case, liability for the death benefit and repatriation expenses, were losses which were the direct and a natural result of the defendant’s breach of contract that caused the death of the claimant’s employee and were not losses of an indirect or consequential nature.

We will turn now to a couple of cases which are similar in content to the original LOGIC drafting but instead place the general words after the specific list. It should be noted that that judicial commentary discussed in the next two cases were however obiter.

The claimants in Ease Faith Ltd v Leonis Marine Management Ltd [2006] 1 Lloyd’s Rep 673 contended, inter alia, that the language “neither the Tugowner nor the Hirer shall be liable to the other party for loss of profit, loss of use, loss of production or any other indirect or consequential damage” implied that loss of profit was only excluded if it was indirect. The claimant did not need to rely on this argument but in any event; the court agreed (obiter) with an earlier authority that the relevant provision “is directed only to indirect loss: [which] is
indicated by the expression “any other indirect or consequential damage”. It was suggested that this was an excessive restriction on a knock-for-knock provision i.e. the language should be capable of excluding a direct loss of profit as well as, if not just instead of, an indirect loss of profit but the judge in Ease Faith disagreed stating, “I do not find it remarkable that parties seeking to exclude all indirect loss but being particularly concerned about indirect loss of profit should agree upon provision that makes specified references to loss of profits...”.

BHP Petroleum Limited v British Steel PLC and Dalmine (2000) also considers the question, obiter, as to the effect of the phrase “or any other indirect loss or consequential damages” coming after a list of specific heads of loss. Despite the structure of the language in BHP being similar to that in Ease Faith, and the commentary being obiter, BHP is nevertheless interesting.

The language of the relevant provision from the BHP contract purported to exclude liability on a mutual basis for:

“loss of production, loss of profits, loss of business or any other indirect loss or consequential damages”

Did the word “other” before “indirect” indicate that “loss of production, loss of profits, loss of business” were only intended to be examples of indirect or consequential loss?

The court in BHP confirmed previous authorities that “indirect or consequential loss” was intended to mean the second limb of Hadley v Baxendale i.e. losses which can only be recovered if they are actually known at the time the contract is made. As this was a hearing of preliminary issues only, the court could not opine on the knowledge elements on the facts before them.

However, Rix J construed the clause as if it read “loss of production, loss of profits, loss of business or any other indirect losses or consequential damages of any other kind”. On his analysis, this meant that each phrase was given its “authoritative meaning” i.e. “loss of profits” being prima facie a direct loss, which must be supposed to have been the parties’ intention. Rix J contended that any potential inference that the former were intended as examples of the latter was an error. The Court of Appeal did not disagree with Rix J’s reasoning. In contrast to Ease Faith, BHP could be considered a pre-cursor to Star Polaris in that it first mooted the natural meaning theory.

In light of Polypearl and Ferryways, in particular, as well as BHP and Ease Faith, it is clear that using a definition, like the original LOGIC language, is not enough to provide a blanket of protection that excludes the type of direct losses that will typically arise from the breach of an oil and gas contract. Such losses (i.e. loss of production, loss of product, loss of use and loss of revenue, profit or anticipated profit) as listed in the above LOGIC language are at risk of being recognised as within the category of “indirect loss”. In that event, the blanket of protection provided by the original LOGIC language is potentially as narrow and deficient as the meaning of “consequential loss” at law.
LOOKING AT THE CONTRACT

From Principles-To-Practice

More recent iterations of LOGIC language provide insight into how drafting has evolved to ensure a broader blanket of protection.

The following sample clause is taken from edition 3 of LOGIC On/Offshore Services, Clause 21 (incidentally, this definition was also used in edition 2 forms, published circa 2001-2004):

“For the purposes of this Clause the expression “Consequential Loss” shall mean:

(a) consequential or indirect loss under English law; and

(b) loss and/or deferral of production, loss of product, loss of use, loss of revenue, profit or anticipated profit (if any), in each case whether direct or indirect to the extent that these are not included in (a), and whether or not foreseeable at the EFFECTIVE DATE OF COMMENCEMENT OF THE CONTRACT.”

The evolution of LOGIC language in this way is aligned with case law and reflects better practice in anticipating the type of structure that the courts will require to ensure a sufficiently clear separation of the meaning of indirect and direct categories of losses within a definition. The key difference in this regard is splitting the definition into two parts: part (a) being general words covering indirect loss of the type contemplated by limb two of Hadley v Baxendale and part (b) being specific language listing certain heads of loss whether direct or indirect.

The further additional language “to the extent that these are not included in (a)” makes it clear that the parties acknowledge that indirect losses could fall under either (a) or (b) and that no adverse inference should be drawn from this.

“foreseeability”

If we look again at the LOGIC edition 3 version of the definition of ‘Consequential Loss’ against the edition 1 version, we also notice the additional words “and whether or not foreseeable at the EFFECTIVE DATE OF COMMENCEMENT OF THE CONTRACT” (emphasis added).

Where parties to a contract wish to exclude specific types of loss, they are likely to want to do so irrespective of the cause of action. It is a well-established fact that there where there is a claim for breach of contract, it is also highly likely that the facts will give rise to a concurrent action in the tort of negligence.

To ensure a claim in tort does not succeed where a breach of contract claim has been defeated by the exclusion, it is necessary to make it clear that the exclusion applies equally to tortious claims. This is commonly done in two ways:
Firstly, and using the LOGIC contracts by way of example, the following express provision (Clause 19.5 in LOGIC On/Offshore Edition 3) is included and applies to the Consequential Loss provision (Clause 21 in LOGIC On/Offshore Edition 3):

“All exclusions and indemnities given under this Clause (save for those under Clauses 19.1(c) and 19.2(c)) and Clause 21 shall apply irrespective of cause and notwithstanding the negligence or breach of duty (whether statutory or otherwise) of the indemnified party or any other entity or party and shall apply irrespective of any claim in tort, under contract or otherwise at law.”

This language covers negligence but also other causes of action such as breach of duty (including statutory duty).

By way of side note, the new Edition 4 LOGIC contracts repeat the above language in the Consequential Loss provision instead of including the cross-reference in the relevant sub-clause of the indemnities provision.

Secondly, the paper makes reference in Part 1 above to the Heron II case which compared the rules of remoteness in contract and tort. Provided loss is foreseeable, it is recoverable in tort. The language, “whether or not foreseeable” is an alternative way of making it clear that the losses are intended to be excluded even if, where the cause of action is negligence, the damage was foreseeable and therefore recoverable.

Robust drafting should include both the “irrespective of cause” language and also the “whether or not foreseeable” language.

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The “blanket of protection”

The right-sized “blanket of protection” is created by all the elements above being combined and structured to ensure the meaning is conveyed as intended. The best practice principles for creating the correct structure can therefore be summarised as follows:

- the naked language “consequential” or “indirect” will not be enough;
- include specific heads of loss relevant to the losses the parties anticipate may occur;
- make it clear that those specific heads of loss are included whether they arise directly or indirectly;
- expressly address foreseeability to avoid issues of recovery of damages in tort.

As we say in the introduction, size matters but so does substance. Our final area of focus is on getting the content right. For this, we can again look at the law.
LOOKING AT THE LAW

“deferral of production”

You may have noticed that “deferral of production” was included in the LOGIC edition 3 definition of Consequential Loss but not edition 1. In the intervening period between publication of these two editions (in fact between edition 1 and edition 2), in the BHP case referred to above, BHP categorised the loss resulting from postponement of exploitation of the field as “deferral of production”, presumably in an attempt to circumvent the exclusion clause which only referred to “loss of production”.

Rix J disagreed with BHP’s proposition stating that this part of the claim was more accurately described as “loss of production” and was therefore excluded; but in the event that that categorisation was incorrect the losses claimed were most certainly loss of profit or business and would thus still be excluded. Rix J also went on to state that “loss of production” and “loss of business” are merely variations of “loss of profit” and therefore following the authority in Deepak “loss of production” and “loss of business” were also prima facie direct losses and thus excluded.

Nevertheless, one can reasonably assume that the revised language included in edition 2 (and later editions) of the LOGIC standard forms, is a result of the argument BHP put forward in this case.

“loss of use”

Turning finally to the most recent cases on consequential loss in the context of oil and gas service sector contracts, we will look at the meaning of “loss of use”.

Transocean Drilling UK Ltd v Providence Resources Plc [2014] EWHC 4260 (Comm)

This case concerned a contract for the hire of a semi-submersible drilling unit, owned and operated by Transocean, to drill an appraisal well offshore Ireland, for Providence. Drilling operations were suspended as a result of the misalignment of part of the blow-out preventer. The period of delay following the suspension gave rise to various disputes between the parties. For the purposes of this paper, we are only concerned with whether Providence had a right to recover additional overheads known as “spread costs” which resulted from the extended period of work.
**LOOKING AT THE CONTRACT**

This is the final sample “consequential loss” definition that we will examine in detail. Rather than appearing in a LOGIC standard form, this language is taken from the International Association of Drilling Contractors (IADC) “Offshore Daywork Drilling Contract” 2003.

“Subject to and without affecting the provisions of this Contract regarding the payment rights and obligations of the parties or the risk of loss, release and indemnity rights and obligations of the parties, each party shall at all times be responsible for and hold harmless and indemnify the other party from and against its own special, indirect or consequential damages, and the parties agree that special, indirect or consequential damages shall be deemed to include, without limitation, the following: loss of profit or revenue; costs and expenses resulting from business interruptions; loss of or delay in production; loss of or damage to the leasehold; loss of or delay in drilling or operating rights; cost of or loss of use of property, equipment, materials and services, including without limitation those provided by contractors or subcontractors of every tier or by third parties.”

As the above language is from a pro-forma contract governed by General Maritime law (a US jurisdiction), we have also reproduced below the exact form of the language in the contract at the centre of the Transocean v Providence dispute to clearly show how expanded “loss of use” language was incorporated into the more familiar LOGIC “consequential loss” definition:

“(i) any indirect or consequential loss or damages under English law, and/or

(ii) to the extent not covered by (i) above, loss or deferment or 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 CONTRACTOR 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 whether or not such losses were foreseeable at the time of entering into the CONTRACT and, in respect of paragraph (ii) only, whether the same are direct or indirect. . . .”

Looking at this language as a “blanket of protection”, we can see that the best practice principles listed above are all incorporated. We have a clear definition of what is “consequential loss”.

Despite the near perfection, if we again turn to the law we can see why substance is as important as form.

**LOOKING AT THE LAW**

Popplewell J, at first instance, concluded that Transocean were in breach, and therefore Providence were, under the circumstances entitled to recover their “spread costs”. These were described in Providence’s evidence as “costs of third party suppliers which have been incurred and paid by Providence, but which would not have been incurred but for Transocean’s failures.”
Transocean argued that “spread costs” were excluded by the words “loss of use” and more specifically, the words in brackets following “loss of use” in the consequential loss definition (in bold above).

Justice Popplewell rejected that argument stating that ““loss of use” 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.”

Although on the face of it, the terms of the clause, the nature of the losses and the circumstances suggested that “spread costs” came within the meaning of the consequential loss exclusion, Justice Popplewell held otherwise as a result of applying various principles of interpretation. Broadly “loss of use” was given context by the other losses listed in the clause: for example “loss of profit”, “profit” being a benefit. A narrow construction was applied. The decision came as a surprise to the industry to say the least.

Transocean appealed but before that appeal was heard Scottish Power UK Plc v BP Exploration Operating Company Ltd and others [2015] EWHC 2658 (Comm) provided further opportunity to consider the meaning of “loss of use”. It concerned a contract for the sale of gas from the Andrew field. During a shut-down, Scottish Power had to procure gas from the market and sought to recover general damages for the additional costs of sourcing gas at a higher price.

Relying on the reasoning of Popplewell J in Transocean, the Andrew owners argued that Scottish Power’s claim was excluded by one or more of the specific heads of loss in the exclusion clause “…loss of use, profits, contracts, production or revenue...”.

Although the court provided alternative reasoning and in any event general damages were not available pursuant to another provision of the contract which Scottish Power appealed, the implication of both decisions was the same: the courts were continuing to construe exclusion clauses very narrowly.

Chronologically, we then arrive at Transocean’s appeal (Transocean Drilling UK Ltd v Providence Resources Plc [2016] EWCA Civ 372) from the first instance decision discussed above. The issue on appeal was whether Providence’s “spread costs” were “consequential losses” within the meaning of a particular clause, Clause 20.

Lord Justice Moore-Bick accepted that Clause 20 was an exclusion clause but that it lacked the characteristics of an exclusion clause to which the rules of restrictive interpretation should apply. This was not a provision whereby one commercially stronger party was excluding or limiting liability for its own breach. Neither was the clause one in which either party could be said to be the proferen and profferee so as to invoke the contra proferentum principle. Rather, this clause pertained to mutual undertakings between parties of equal bargaining power and in any event the language of the clause was unambiguous.

He acknowledged that courts were historically willing to construe exclusion clauses restrictively to avoid commercial oppression but that more recently there had been a shift in attitude in favour of giving the language used by the parties its natural meaning, most recently emphasis by the Supreme Court in Arnold v Britton [2015] UKSC 36, [2015] ac 1619.

To that end Moore-Bick LJ started by looking at the language of the clause. He stated that “loss of use” “naturally refers to the loss of the ability to make use of some kind of property or equipment” but that the words in brackets indicate the parties’ intention that the scope of “loss of use” should be even wider than that, i.e. cover the “loss of use or cost of use of services provided by contractors, sub-contractors and third parties”. Moore-Bick LJ was simply restating the plain words used in the contract and was not applying any rules of
interpretation. He also noted that twice in the same phrase the words “without limitation” were used, further emphasising the unrestricted meaning the parties intended.

Taking this approach, Moore-Bick LJ held that “the natural meaning of the words the parties have used is apt to include wasted spread costs”. He allowed the appeal.

The Supreme Court declined to hear an appeal by Providence on the basis that the additional modifying language was a variation to the industry standard which meant the case did not raise a “point of law of general public importance.”

Has this decision finally haled a new era of commercial certainty when defining consequential loss?

The simple answer is no.

In the Transocean appeal, at paragraph 24, Moore-Bick LJ asserted that Popplewell J was correct to construe the expression in the context of the whole clause and was prepared to concede that “loss of use” standing alone, could be construed as Popplewell J concluded. Moore-Bick LJ believed that where Popplewell J erred was in failing to give sufficient regard to the words in brackets. Those words were intended to expand the meaning of “loss of use”. The phase “loss of use” was not intended to limit the meaning of those words.

The Transocean appeal overturned not only Popplewell J’s decision but, most significantly, cast doubt on his approach. Would this affect the interpretation of “loss of use” in the Scottish Power appeal?

Unfortunately we will never know because clause 4.6 of the contract between Scottish Power and BP relating to consequential loss was not considered further by the Court of Appeal. This is particularly disappointing given that Moore-Bick LJ heard the appeal but did not provide further clarity on the meaning of “loss of use” standing alone.

Any further clarity would have been an important consideration for anyone using a consequential loss definition which refers to “loss of use” without expansion. This is the drafting used in the latest editions of the LOGIC contracts.
CONCLUSION

At the beginning of this paper, we outlined two propositions:

• **Proposition One**: Although “consequential loss” is recognised at law in most jurisdictions we know, with certainty, that when drafting an oil & gas contract relying on the law is not enough.

• **Proposition Two**: If you cannot rely on “consequential loss” at law, we know that you need to define it in the contract and we also know, with certainty, that “it is not easy to define”.

The purpose of those two propositions was setting out a clear framework to answer the principal question - “what is “consequential loss”?”

We have considered in detail why so much uncertainty exists and distilled certain best practice principles that should be followed. We follow these principles, not to answer a question that seems to be unanswerable, but to mitigate and manage the risks that the uncertainty presents in practice.

We know the naked language is not enough. We know the blanket of protection has to be properly created in order to be effective.

Despite judicial and commercial attempts at defining “consequential loss”, it remains uncertain as to whether a particular loss will fall under either limb of *Hadley v Baxendale* or even whether the test in *Hadley v Baxendale* remains relevant today.

Paragraph 15 of Moore-Bick LJ’s judgment in *Transocean* refers to the earlier decisions in *Croudace* and *Deepak* acknowledging that “it is questionable whether some of those cases would be decided in the same way today, when courts are more willing to recognise that words take their meaning from their particular context and that the same word or phrase may mean different things in different documents.”

That assertion plainly suggests that the concept of “indirect or consequential loss” is unlikely to ever be distilled to a simple answer to a simple question. The recent tension between the legal meaning and natural meaning of the words “consequential loss” only increased the complexity of the concept.

In the *BHP* case discussed above, British Steel submitted that the authorities on the meaning of “indirect and consequential loss” gave the words a narrower meaning than would be “intended by businessmen party to a contract such as the one in the present case”.

From the more recent decisions in *Transocean v Providence* and *Star Polaris*, it certainly seems that the natural meaning argument is gaining strength versus the legal meaning drawn along the limbs of *Hadley v Baxendale* but as the common law currently stands this proposition only serves to emphasise the importance of defining “consequential loss” and adopting best practice in drafting.
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