

Construction Law Update

Interpreting Indirect and Consequential Loss Exclusion Clauses

Traditionally, the English courts have applied a very narrow interpretation to indirect loss and expense exclusion clauses. In the recent case of *2 Entertain Video Ltd (“2E”) v Sony DADC Europe Ltd (“Sony”)*, the TCC has considered whether a more case-by-case approach to interpretation would be more appropriate.

Background

In May 2011, Sony and 2E entered into an agreement under which Sony would provide storage facilities to 2E at its distribution warehouse in Enfield. In August 2011, rioting and violent civil disorder broke out across London and Sony’s warehouse, which was holding approximately £40 million worth of stock owned by 2E was destroyed by a fire.

2E sued Sony for loss of profit arising from the fire. Sony, on the other hand, argued that 2E’s claim for loss of profit was precluded as a result of the following indirect and consequential loss exclusion clause:

“Neither party shall be liable under this Agreement in connection with the supply of or failure to supply the Logistics Services for any indirect or consequential loss or damage including (to the extent only that such are indirect or consequential loss or damage only) but not limited to loss of profits, loss of sales, loss of revenue, damage to reputation, loss or waste of management or staff time or interruption of business.”

Interpreting indirect and consequential loss exclusion clauses

The traditional approach taken by the English courts is that indirect and consequential loss exclusion clauses will be limited to those losses which fall within the second limb of *Hadley v Baxendale*, a well-known case which distinguishes between two types of recoverable loss:

- Limb One – Losses arising naturally, or in the usual course of things, or that may be fairly and

reasonably within the contemplation of the parties when the agreement was entered into.

- Limb Two – Losses that result from special circumstances which will only be recoverable if the other party knows of those circumstances.

The difference between the two limbs relates to the foreseeability, rather than the nature, of the loss. This has led to judicial criticism suggesting this approach is inconsistent with what would be expected by the average businessman.

In this case, the TCC took the view that *“any general understanding of the meaning of ‘indirect or consequential loss’ must not override the true construction of that clause when read in context against the other provisions in the [agreement]”*. The TCC found that the “plain and natural” meaning of ‘indirect and consequential losses’ fell within the second limb of *Hadley v Baxendale*. Consequently, the TCC found in 2E’s favour on the basis that the losses claimed were all direct, being exactly the type of loss you would expect in the circumstances.

Analysis

This case is likely to add to the debate concerning the correct method of interpreting indirect and consequential loss clauses. Although the TCC did apply the traditional approach to interpretation, it also acknowledged the need to consider the natural meaning of the words ‘indirect’ and ‘consequential’ within the context of the agreement as a whole.

Going forwards, parties should be as clear as possible when drafting clauses seeking to exclude specific types of loss and should also be aware of the arguments for broadening the traditional approach to interpreting such clauses.

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