CONSEQUENTIAL LOSS: IT'S ALL IN THE DEFINITION

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INTRODUCTION

Recent developments in NSW reinforce the importance of not only expressly defining the term 'consequential loss' in contracts, but also carefully considering what categories of losses the exclusion is intended to cover, in order to avoid unintended consequences.

Recent Historical Context

Until recently[1] it was generally accepted by parties to contracts, and the courts in Australia, that the term 'consequential loss' meant those losses falling under the second limb of losses described in *Hadley v Baxendale*[2] and which Lord Alderson B categorised as Indirect Loss (or subjectively foreseeable loss).

These Indirect Losses were held to be losses which are not a direct consequence of the breach, and were therefore not fairly and reasonably considered as "arising naturally" or "in the usual course of things", from the breach itself. As such, "consequential loss" was not found to encompass damages for loss of profits or expenses incurred to remedy a breach of contract as these were considered outside of that definition.

In *Peerless*, the Victorian Court of Appeal departed from previous English authorities and, in so doing, narrowed the ability of parties to recover certain types of damages under a contract excluding liability for "consequential loss".

The Court provided a judicial definition of the concept of "consequential loss" based on a distinction between:

- "normal loss, which is loss that every plaintiff in a like situation will suffer"; and
- "consequential loss, which is anything beyond the normal measure, such as profits lost and expenses incurred through breach".

The *Peerless* decision has been followed in NSW in *Allianz Australia Insurance Ltd v Waterbrook at Yowie Bay Pty Ltd*[3] ("Allianz"), and in SA in *Alstom Ltd v Yokogawa Australia Pty Ltd and Anor (No 7)*[4] ("Alstom").

However, whilst the *Peerless* decision signalled a shift in some Australian courts' approach to the interpretation of the term "consequential loss", the Western Australian decision of *Pacific Hydro*[5] demonstrates that the law in this area is far from settled.

In *Pacific Hydro*, Justice Martin did not follow *Hadley v Baxendale* or *Peerless* in attempting to define consequential loss, preferring to construe the clause according to its natural and ordinary meaning, read in light of the contract as a whole, and so as to ascertain the parties commercial intention at the time of striking their agreement.

[1] Environmental Systems Pty Ltd v Peerless Holdings Pty Ltd [2008] VSCA 26.

[2] (1854) 9 Exch 341, [354].

[3] [2009] NSWCA 224.

[4] [2012] SASC 49.

[5] *Regional Power Corporation v Pacific Hydro Group Two Pty Ltd [No 2]* [2013] WASC 356.

Accordingly, it is clear that at the moment the approach to the interpretation of 'consequential loss' in exclusion clauses in Australian contract law is far from settled. This uncertainty has prompted contracting parties, and their advisors, to re-emphasise the importance of incorporating into their contracts an extensive definition of consequential loss. The most recent case on 'consequential loss' however, suggests that even closer attention must be paid to the breadth of the definition itself, to avoid potentially unintended outcomes.

Breadth of Definition and the Macmahon Case

In the *Macmahon*[6] case, Cobar contracted with Macmahon to design and construct certain works for the development of Cobar's copper mine in NSW. Approximately two years into the Contract term, Cobar wrote to Macmahon giving notice of termination for breaches which it said, were material and incapable of remedy, and for which the contract granted Cobar termination rights. Macmahon, asserted that the termination was invalid, and that the letter of termination constituted a repudiation of the contract.

Macmahon sued for damages for what it said was Cobar's repudiation of the Contract. One of the heads of damage claimed was described as "loss of opportunity to earn profit"[7]. Macmahon argued that, had the contract continued to completion, it would have made substantial profits, and that the wrongful termination of the contract had denied it the opportunity to earn those profits.[8]

The parties agreed that the Contract had been brought to an end by one party's acceptance of the other's repudiation. A preliminary question for the judge was, assuming that Macmahon's claim regarding the repudiation was made out, what damages were payable as a result of that termination, in light of an exclusion clause which contained an agreed definition for "consequential loss", which, amongst other things, included "loss of contract".

What was not clear was whether the term "loss of contract" in the definition of "consequential loss" was intended to refer to simply other contracts, such as subcontracts or other contracts that could be current or effective with third parties in place of the existing contract, or whether this extended to the contract the subject of the dispute. Cobar asserted the latter in an attempt to defeat Macmahon's claim for "loss of opportunity to earn profit" under the terminated contract.

In determining the commercial intention of the parties, Justice McDougall held that it was common ground that the words "loss of contract" were intended to catch loss of the benefit both of the particular contract in which the provision excluding liability for consequential loss appeared, and other, or third party, contracts, the benefit of which might be lost to one party as a result of some breach by the other of the parties' own contract.[9] His Honour found this to be the case despite the fact that the word "contract" was not capitalised in the expression "loss of contract" (in circumstances where the word "Contract" itself was defined and used in the contract in question)[10].

As loss of the benefit of the contract in question would ordinarily be a consequence of accepted repudiation, Cobar was held not liable for repudiation of contract damages, as such damages were excluded by virtue of the exclusion of consequential loss. In deciding this point his Honour accepted that this construction would give either party the ability to act in a way that might deprive the other of the future benefit of the contract, without having any liability for loss of that benefit.[11]

SUMMARY

Irrespective of what the cases have decided from *Hadley v Baxendale*, through *Peerless*, *Allianz*, *Alstom* and then to *Pacific Hydro*, the message remains the same - best practice has always been to ensure a considered definition of "consequential loss" is included in contracts where the parties are seeking to exclude or deal with consequential loss in some way.

Given the decision of *Macmahon*, being the most recent case on consequential loss, it is clear that this advice still stands, however, careful attention must also be paid to what types of loss the definition of "consequential loss" is intended to cover, in order to avoid the court interpreting the commercial intention of the parties in a way which leads to unintended consequences for one, or both parties.

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[6] *Macmahon Mining Services v Cobar Management* [2014] NSWSC 502.

[7] *Macmahon Mining Services v Cobar Management* [2014] NSWSC 502 [4].

[8] Ibid.

[9] Ibid [27].

[10] Ibid [28].

[11] Ibid [32].