Comparative analysis of aspects of damages: consequential loss and classification

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Abstract

Purpose This paper critically reviews the judicial approach to aspects of contract damages in England and Wales, Australia and New Zealand.

Methodology The paper is confined to damages issues with particular emphasis on agreed remedies and will discuss leading judgments of the three jurisdictions and academic commentary.

Rationale There are a variety of agreed remedies, the main one being the agreed price. Others include liquidated damages and exception clauses which are the focus of this paper. The meaning of loss must be determined before any remoteness issues are addressed. In the case of liquidated damages, do the other limitations on damages play a part? What is the meaning of the term ‘consequential loss’ which frequently appears in exception clauses? This was at issue in Croudace Construction Ltd v Cawoods Concrete Products Ltd, Environmental Systems Pty Ltd v Peerless Holdings Pty Ltd and Oceania Furniture Ltd v Debonaire Products Ltd. Fuller and Perdue classified damages interests as expectation, reliance and restitution. While their terminology has had a substantial influence on contract damages, the classification is no longer appropriate. Attorney General v Blake has changed the face of contract damages and a claim is now possible on a restitutionary basis, but is it likely to result in a change to agreed damages clauses?

Conclusions The incorporation of agreed remedies facilitates the predictability of the outcomes of contracts. The assessments of damages in the jurisdictions discussed follow common precedents, but in some areas, such as the meaning of ‘consequential loss’ in exclusion clauses, the judgments indicate a difference in approach. It is vital that what is in the contract is clearly stated and intended by both parties.

Keywords Damages, Classification, Consequential, Liquidated, Exclusion Clauses.

1 Introduction

Parties entering a contract are entitled to create mutual rights and duties by agreement. “What the parties have agreed should normally be upheld. Any other approach will lead to undesirable uncertainty especially in commercial contracts”. If there is a dispute between the parties as to what is covered and the matter turns on the wording of the contract, there will be variations between jurisdictions depending on the issue in dispute. There is a wide variety of agreed remedies and the main types relate to financial payments. Despite the general principle of freedom of contract there are various rules that involve a balancing of values, and relief is given on the basis of fairness. This is evident in relation to the penalty clause jurisdiction. Of major importance in commercial contracts are liability provisions which can be contentious. An exclusion clause limits a party’s liability and for that reason it is likely to be carefully negotiated. However, in

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2 [2008] VCSA 26 (CA).
5 [2001] 1 AC 268 (HL).
6 Philips Hong Kong Ltd v The AG of Hong Kong (1993) 61 BLR 49 (PC) 59 (Lord Woolf).
most commercial contracts “the value of protecting the weak, the foolish, and the thoughtless from imposition and oppression”\(^7\) is generally irrelevant. This paper considers aspects of the efficacy of these agreed remedies in protecting a party’s contract interests in England and Wales, Australia and New Zealand.

2  Protected interests in contract law and assessing loss

Fuller and Perdue’s article has been extremely influential and their terminology continues to be utilised by the Courts\(^8\) but it is not without its critics\(^9\). Three principal purposes which may be pursued in contract damages are distinguished:

Following a breach of contract the innocent party may have:

(i) a **restitution interest**, namely the right to restoration of a valuable benefit conferred on the other party, the object being to prevent unjust enrichment;

(ii) a **reliance interest**, namely the right to compensation for loss due to steps taken by the innocent party in reliance upon the existence of the contract, the object being to restore the innocent party to the position which he or she would have occupied had the contract not been made; and/or

(iii) an **expectation interest**, namely the right to compensation for loss of the bargain, the object being to financially restore the innocent party to the position which he or she would have occupied had the contract been performed.\(^10\)

In *C&P Haulage v Middleton*\(^11\) the article was cited in relation to the reliance interest, which is applicable in limited situations. It is best viewed as protecting the expectation interest.\(^12\) Rowan\(^13\) discussing the contractual performance interest calls it “a label now used in place of the more traditional ‘expectation interest’”. However, a search through the cases in the three jurisdictions does not confirm that the judiciary has replaced the label ‘expectation’ with ‘performance’. Certainly there has been much academic comment as to the lack of protection of the performance interest. The cases demonstrate that where appropriate the courts have paid due regard to the performance interest. It cannot be said that the performance interest has replaced the expectation interest.

The two main methods of assessing the plaintiff’s loss can be described as a cost of cure award and a difference or diminution of value award. They are particularly relevant for building contracts, but they will apply to any type of contract. In the case of cost of cure, the plaintiff is awarded the cost of curing the breach. Diminution of value is the difference in value between what was contracted and what was supplied. If there is no possible replacement, this may be the only

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\(^7\) S M Waddams “Unconscionability in contracts” (1976) 39 (4) MLR 369.


\(^10\) Fuller and Perdue (n 4).


\(^13\) Solene Rowan “For the recognition of remedial terms agreed inter partes” (2010) 126 LQR 448.
available measure. The recent Australian High Court case, *Tabcorp Holdings Ltd v Bowen Investments Pty Ltd*\(^{14}\) highlights the importance of performance of contracts, which is a feature of the expectation interest. In that case, a tenant with “contumelious disregard for the landlord’s rights”\(^{15}\) breached a leasehold covenant and destroyed the foyer and replaced it. The damages in the lower Court were AUSS34,820, being the difference in value of the property with the old foyer and its value with the new foyer. On appeal, the damages were assessed on the cost of cure basis by the full Federal Court. This resulted in an increase to AUSS1.38m being the estimated cost of reinstatement of the foyer to its former condition ($580,000) and loss of rental income during the four month period in which such works would be carried out ($800,000). The High Court of Australia dismissed the appeal and held that the appropriate measure was cost of cure. The Court reiterated the “ruling principle” with respect to damages as stated by Parke B in *Robinson v Harman*\(^{16}\). The Court expressed agreement with Oliver J’s statement in *Radford v De Froberville*\(^{17}\) that the words ‘the same situation, with respect to damages, as if the contract had been performed’ do not mean ‘as good a financial position as if the contract had been performed’.\(^{18}\) *Ruxley Electronics and Construction Ltd v Forsyth*\(^{19}\) was distinguished on its exceptional facts. The High Court of Australia referred to the facts:

‘The House saw the following matters as indicating that the cost of reconstruction was not recoverable: ‘The trial judge made the following findings which are relevant to this appeal: (1) the pool as constructed was perfectly safe to dive into; (2) there was no evidence that the shortfall in depth had decreased the value of the pool; (3) the only practicable method of achieving a pool of the required depth would be to demolish the existing pool and reconstruct a new one at a cost of £21,560; (4) he was not satisfied that the respondent intended to build a new pool at such a cost; (5) in addition such cost would be wholly disproportionate to the disadvantage of having a pool of a depth of only 6ft as opposed to 7ft 6in and it would therefore be unreasonable to carry out the works; and (6) that the respondent was entitled to damages for loss of amenity in the sum of £2,500.’\(^{20}\)

In *Ruxley Electronics*, the plaintiff was awarded £2,500 amenity damages. The case has been criticised as it fails to protect the performance interest. However, the above facts support the view that in the particular circumstances it was not reasonable for the plaintiff to require complete replacement or reinstatement.

Rowan\(^{21}\) argues that the force and logic of freedom of contract should extend the available agreed remedies. The reason to advocate cost of cure damages clauses, restitution, penalty and specific relief clauses is to provide adequate protection to the performance interest. However, reasonableness is a vital ingredient of contract relief and it would be unlikely that the courts would agree that there was such a need. This

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15 (2009) 83 A LJR 390 (HCA) [4].
16 (1848) 1 Exch 850 855.
17 [1977] 1 WLR 1262 1273.
21 Rowan (n 13) 448.
is evident from the New Zealand Court of Appeal discussion in relation to exemplary damages in contract law:

There is certainly no need for exemplary damages to fill any hole in the range of compensatory damages in the contract field. Contractual remedies now available in appropriate cases include expectation damages, reliance damages, and damages for non-pecuniary loss, mental distress, disappointment and loss of amenity. It has even been suggested that a Court could order an account of profits as a contractual remedy (Attorney-General v Blake [2001] 1 AC 268). In addition, in appropriate cases, indemnity costs may be available for improper conduct in the course of litigation. And, of course, also within the Court’s armoury are the non-monetary remedies of injunction and specific performance. There is no reason in principle to add yet another remedy to the above list that would give a contracting party a windfall profit over and above that which it had bargained for.  

The New Zealand Court of Appeal referred to overseas authority and stated that it was “particularly influenced by the detailed reports undertaken by the law commissions in the England and Wales and Ireland”.

In the House of Lords in Attorney-General v Blake it was held that the Crown was not entitled to restitutionary damages but to an account of profits. It was clear that these are both exceptional remedies. In the case of a restitution or account of profits clause it would be impossible to assess the profit likely to be made and if all the profits were stipulated then that would be a penalty. It seems likely that the courts would regard a restitution clause as penal as “agreed remedies will to some extent be assessed in line with the judicial remedies available”.

3 Agreed damages

In this section it is proposed to consider the approach of the three jurisdictions to the agreed remedies of liquidated damages and exclusion clauses. The interpretation of a contract will be particularly important when the contract excludes or limits liability. The courts have developed rules which at times may not reflect a possible objective interpretation but produce a fair result.

3.1 Liquidated damages

At the time of contracting, the parties may make provision in their contract as to what damages shall be recoverable in the event of breach. If there is a dispute and the damages are classified ‘liquidated damages’ then the clause will be enforced, but it will not be enforced if it is held to be a ‘penalty clause’.

The applicable principles are those summarised by Lord Dunedin in Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd:

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22 [2006] 3 NZLR 188 (CA) 223(Chambers J).
23 [2006] 3 NZLR 188 (CA) 223(Chambers J).
25 Burrows (n 12) 445.
(a) It will be held to be a penalty if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach …

(b) It will be held to be a penalty if the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid …

(c) There is a presumption (but no more) that it is a penalty when a single lump sum is made payable . . . on the occurrence of one or more or all of several events, some of which would occasion serious and others but trifling damage . . .

(d) It is no obstacle to the sum stipulated being a genuine pre-estimate of damage, that the consequences of the breach are such as to make precise pre-estimation almost an impossibility.26

The task of the court is one of construction and it may take into consideration the “inherent circumstances of each particular contract, judged as at the time of the making of the contract, not at the time of the breach…”27 The law as to penalties is well settled but recent formulations have adopted different terminology “to avoid the phrase ‘in terrorem’:

...whether a provision is to be treated as a penalty is a matter of construction to be resolved by asking whether at the time the contract was entered into the predominant contractual function of the provision was to deter a party from breaking the contract or to compensate the innocent party for breach. That the contractual function is deterrent rather than compensatory can be deduced by comparing the amount that would be payable on breach with the loss that might be sustained if breach occurred.28

There is a predisposition towards upholding commercial contracts to provide certainty, as was emphasised by Lady Justice Arden in Murray v Leisureplay plc29. Arden LJ considered that “A pre-estimate is genuine if it is not unreasonable in all the circumstances of the case.”30 Buxton LJ disagreed, as this overlooked one of Lord Dunedin’s principal tests31 and introduced a rigid and inflexible element into what should be a broad and general question”32. A clause is not a penalty unless it is ‘extravagant or unconscionable’ but neither the literal wording of that test nor the spirit of it applied to this case. Buxton LJ adopted Dunlop’s test as recast in modern terms by Colman J in Lordsvale Finance plc v Bank of Zambia33 (see above quote) and approved by Mance LJ in Cine Bes Filmcilik Ve Yapim Click v United International Pictures34. Clarke LJ preferred the broader approach of Buxton LJ. The English Court of Appeal held that the clause, which provided for a full year’s salary in the event of a wrongful

27 [1915] AC 79 (HL) 87.
29 [2005] EWCA Civ 963(CA(Civ Div)).
31 Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd [1915] A C 79 87. “It will be held to be a penalty if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach.” See also Ringrow Pty Ltd v BP Australia Pty Ltd (2005) 80 ALJR 219 (HCA) [32]: “It must be ‘out of all proportion” and Philips Hong Kong Ltd v Attorney–General of Hong Kong (1993) 61 BLR 41 (PC) 57.
32 [2005] EWCA (CA (Civ Div)) 963 [114].
34 [2003] EWCA Civ 1669 (CA).
dismissal, was not a penalty. The amount payable greatly exceeded what would be payable at common law but other justifications such as market expectations, restraint of trade clause, a clean break, avoiding lengthy litigation and damaging publicity were relevant. The clause while “generous” was not ‘unconscionable’.

The courts have in recent times adopted a more liberal attitude to the enforcement of liquidated damages clauses where the test of commercial justification is satisfied. In *Alfred McAlpine Capital Projects Ltd v Tilebox Ltd* 35 Jackson J referred to the fact that the “rule about penalties is an anomaly within the law of contract” and that there is a strong predisposition to uphold the contractual term “in the case of commercial contracts freely entered into between parties of comparable bargaining power”.

The emphasis on ‘extravagant and unconscionable’ suggests the importance of the unfairness, which is also evident from the Australian and New Zealand decisions. The High Court of Australia in *Ringrow Pty Ltd v BP Australia Pty Ltd* 36 confirmed that the starting point of any discussion is Lord Dunedin’s speech in *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* 37. The Court stated:

Exceptions from that freedom of contract require good reason to attract judicial intervention to set aside the bargains upon which parties of full capacity have agreed. That is why the law on penalties is, and is expressed to be, an exception from the general rule. It is why it is expressed in exceptional language. It explains why the propounded penalty must be judged ‘extravagant and unconscionable in amount’. It is not enough that it should be lacking in proportion. It must be ‘out of all proportion’. It would therefore be a reversal of longstanding authority to substitute a test expressed in terms of mere disproportionality. 38

Lord Woolf in *Philips Hong Kong Ltd v Attorney General of Hong Kong* 39, delivering the opinion of the Privy Council, approved the words of Dickson J in the Supreme Court of Canada in *Elsey v J G Collins Insurance Agencies Ltd* 40, namely:

> It is now evident that the power to strike down a penalty clause is a blatant interference with freedom of contract and is designed for the sole purpose of providing relief against oppression for the party having to pay the stipulated sum. It has no place where there is no oppression.

The above words of Dickson J were also approved by the Australian High Court in *Esanda Finance Corporation Ltd v Plessnig* 37. The New Zealand Court of Appeal in *Amaltal Corporation Ltd v Maruha (NZ) Corporation Ltd* 42 also cited the dicta and concluded that the power to strike down a clause as a penalty, which was developed in the public interest, is “concerned with relief against oppression or unconscionable behaviour by a contracting party” 43.

The courts refuse to enforce penalty clauses as unlike liquidated damages they do not reflect the compensatory principle of contract law. Some argue that a penalty clause

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42 [2004] 2 NZLR 614 (CA).
43 [2004] 2 NZLR 614 (CA) [59] (Blanchard J).
would promote the fulfilment by the parties of the contractual obligations. For Rowan, “the most persuasive argument in support of penalty clauses is the paramount importance of freedom of contract”.\footnote{Rowan (n 13) 460.} In Alfred McAlpine Capital Projects Ltd v Tilebox Ltd\footnote{[2005] BLR 271 280.} Jackson J referred to the fact that in the four cases where his Honour found a clause which was struck down as a penalty; “there was in fact a very wide gulf between (a) the level of damages likely to be suffered and (b) the level of damages stipulated in the contract.”

Questions arise as to whether the normal limitations of remoteness and mitigation must be taken into account in a consideration of liquidated damages. Lord Justice Diplock in Robophone Facilities Ltd v Blank\footnote{[1966] 1 WLR 1428 (CA) 1448.} was of the view that if a stipulated sum was a genuine pre-estimate, it would be liquidated damages even if it was beyond the defendant’s normal loss under the remoteness rules. In Abrahams v Performing Right Society Ltd\footnote{[1995] ICR 1028 (CA).} Hutchison J referred to the fact that the liquidated damages clause facilitates recovery of damages and stated obiter that mitigation was not relevant in the case of liquidated damages. In Murray v Leisureplay plc\footnote{[2005] EWCA Civ 963(CA (Civ Div)) [115].} Lord Justice Buxton also referred to the fact that “a liquidated damages clause ‘saves the expense and difficulty of bringing witnesses to that point’”.\footnote{Kemble v Farren (1829) 6 Bing 141 148 (Tindal CJ).} He concluded:

And a clause that made reference to the duty to mitigate would also inevitably postpone payment under the clause well beyond the termination date: again, something that the inclusion of such a clause in the contract must have been intended to avoid. This last consideration strongly reinforces the general impression created by this case, that the traditional learning as to penalty clauses is very unlikely to fit into the dynamics of an employment contract, at least when the penalty is said to be imposed on the employer.\footnote{[2005] EWCA Civ 963(CA (Civ Div)) [115].}

### 4 Exclusion clauses and ‘Consequential’ or ‘Indirect’ Loss

Clauses excluding liability have been a source of litigation and there are clear differences as to the meaning of consequential or indirect loss in England and Wales, Australia and New Zealand.

#### 4.1 England and Wales

There is a long line of English case law\footnote{See British Sugar Plc v NEI Power Projects Ltd (1997) 87 BLR 42 (CA); Deepak Fertilisers and Petrochemicals Corp v ICI Chemicals & Polymers Ltd [1999] 1 Lloyd’s Rep 387 403 (CA); Pegler Ltd v Wang (UK) Ltd [2000] BLR 218; 70 Con LR 68; Addax Ltd v Arcadia Petroleum Ltd [2000] 1 Lloyd’s Rep 493 496; Hotel Services Ltd v Hilton International Hotels (UK) Ltd [2000] 1 All ER (Comm) 750; [2000] EWCA Civ 7(CA), Watford Electronics Ltd v Sanderson CFL Ltd [2001] BWCA 5(CA); Leicester Circuits Ltd v Coates Brothers plc [2003] EWCA Civ 290 (CA); GB Gas v Accenture(UK) Ltd and others [2009] EWHC 2734 (Comm).} that has consistently followed Millar’s Machinery Co v David Way & Son\footnote{(1935) 40 Com Cas 204 (CA).} and Croudace Construction v Cawoods Concrete Products\footnote{[1978] 2 Lloyd’s Rep 55 (CA).}. The English courts have adopted a narrow view of the meaning of ‘indirect’
or ‘consequential’ loss. This view which has been consistently followed in England and Wales is that the words ‘directly’ and ‘indirectly’ refer respectively to the first and second limb in *Hadley v Baxendale*:

Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e. according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of it.  

In *Hotel Services Ltd v Hilton International Hotels (UK) Ltd*55, the Court was concerned with loss following the installation of defective minibars in hotel rooms. Hilton was awarded damages for the rental either overpaid or paid on a failed consideration, the cost of removal and storage of the chiller units and cabinets and the loss of profit on the minibars. An exemption clause excluded liability “for any indirect or consequential loss, damage or liability arising from any defect in or failure of the System or any part thereof or the performance of this Agreement or any breach hereof by the Company or its employees”. The Court concluded that both the cost of removal and the loss of any profits which it would otherwise have been earning were direct or natural consequences and were not covered by the exemption clause “which (since all recoverable loss is literally consequential) plainly uses ‘consequential’ as a synonym of ‘indirect’. But nothing, at least in this area of the law, is so simple.”56

The Court considered four authorities beginning with *Croudace Construction Ltd* where the distinction drawn at first instance by Parker J between consequential loss and natural or direct loss for the purposes of an exclusion clause was held to be correct on appeal. In *British Sugar plc v Nei Power Projects Ltd*57 the contract between the plaintiffs and defendants was for the design, supply, delivery, testing and commissioning of electrical equipment by the defendants. The plaintiffs allege that the equipment was poorly designed and badly installed, which resulted in breakdowns in the power supply. At issue on appeal was whether the words seeking to place a limitation on liability for damages in relation to ‘consequential loss’ did or did not apply to loss flowing directly and naturally from a breach. The Court of Appeal rejected the submission that ‘consequential’ loss, to a reasonable businessman, would include loss of profits. Waller J adopted *Croudace Construction* and *Millar’s Machinery* in which closely similar exclusion clauses were at issue, and stated that:

.... once a phrase has been authoritatively construed by a court in a very similar context to that which exists in the case in point, it seems to me that a reasonable businessman must more naturally be taken to be having the intention that the phrase should bear the same meaning as construed in the case in point.58

Loss of profits and indirect or consequential loss were excluded in *Deepak Fertilisers Ltd v ICI Chemicals and Polymers Ltd*59. The Court considered that it was bound by *Croudace Construction* where a similar loss was held to be direct loss. The final

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54 (1854) 9 Exch 341.
55 [2000] 1 All ER (Comm) 750 (CA).
56 [2000] 1 All ER (Comm) 750 [8 -9] (CA) (Sedley LJ delivering the judgment of himself, Lady Justice Hale and Mr J Rattic).
57 (1997) 87 BLR 42 (CA).
58 (1997) 87 BLR 42 (CA) (Waller LJ with whom Evans and Aldous LJ agreed).
authority considered in Hotel Services Ltd was BHP Petroleum Ltd v British Steel plc, where Rix J concluded:

... the parties are correct to agree that authority dictates that the line between direct and indirect or consequential losses is drawn along the boundary between the first and second limbs of Hadley v Baxendale.

Counsel for Hotel Services, the appellant, argued that McGregor’s view should be adopted. McGregor defined ‘normal’ losses as those which every plaintiff in a like situation will suffer, whereas ‘consequential’ losses were those peculiar to the particular claimant’s circumstances. “Consequential losses are anything beyond this normal measure, such as profits lost or expenses incurred through the breach, and are recoverable if not too remote. The distinction is not the same as that between the first and second rules in Hadley v Baxendale: a consequent loss may well be within the first rule.” The Court of Appeal rejected this approach. Sedley LJ concluded that:

We prefer therefore to decide this case, much as Victoria Laundry was decided, on the direct ground that if equipment rented out for selling drinks without defalcations turns out to be unusable and possibly dangerous, it requires no special mutually known fact to establish the immediacy both of the consequent cost of putting it where it can do no harm and - if when in use it was showing a direct profit - of the consequent loss of profit. Such losses are not embraced by the exclusion clause, read in its documentary and commercial context.

The recent High Court decision GB Gas v Accenture strictly adhered to the Croudace approach. Accenture plc contracted to design, supply, install and maintain a new IT system (the Jupiter System), including an automated billing system based on pre-packaged SAP IS-U software. The exclusion clause read:

16.2 Consequential Loss
Subject to Clause 16.7 or as otherwise expressly provided in this Agreement, in no event shall either Party be liable whether in contract, tort (including negligence) or otherwise in respect of any of the following losses or damages:
16.2.1 loss of profits or of contracts arising directly or indirectly;
16.2.2 loss of business or of revenues arising directly or indirectly;
16.2.3 any losses, damages, costs or expenses whatsoever to the extent that these are indirect or consequential or punitive

It was common ground that the words ‘directly’ and ‘indirectly’ in Clause 16.2 referred respectively to the first and second limb of the rule in Hadley v Baxendale.

Lord Hoffmann in Caledonia North Sea v British Telecommunications plc reserved his view as to whether the interpretation adopted in the Hotel Services line of cases was correct.

4.2 Australia

Consequential loss was at issue in the decision of the Supreme Court of Victoria, Environmental Systems Pty Ltd v Peerless Holdings Pty Ltd. Peerless, an organic

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62 [2000] 1 All E R (Comm) 750 [20].
64 [2009] EWHC 2734 (Comm) [77].
65 (1854) 9 Exch 341
recycling company, required a replacement afterburner. It accepted a written proposal from Environmental Systems Pty Ltd (ES) to replace the afterburner with a Regenerative Thermal Oxidiser (RTO). The system was installed and commissioned in October 1998. Despite considerable efforts to make the RTO work it was eventually shut down by Peerless in late July or August. Peerless sued ES for damages for breach of contract, among other actions. The following exclusion clause was in the agreement: Cl 8.9 “As a matter of policy, ES does not accept liquidated damages or consequential loss...”

The judge at first instance held that the expression ‘consequential loss’ in the exception clause referred to losses recoverable only under the second limb of Hadley v Baxendale. The appellant contended that upon its proper construction ‘consequential loss’ in clause 8.9 meant any losses that a business person would understand that term to embrace (in other words, any losses consequent upon a breach other than ‘liquidated damages’). Nettle J A (with whom Ashley and Dodds-Streeton JJA agreed) considered that the English authority appeared to be flawed. Reference was made to the view expressed in the earlier editions of McGregor on Damages that “the true distinction is between ‘normal loss’, which is loss that every plaintiff in a like situation will suffer, and ‘consequential losses’, which are anything beyond the normal measure, such as profits lost or expenses incurred through breach”. This distinction, McGregor explained, was evident in ss 50 and 51 of the Sale of Goods Act 1893 (Eng), which dealt with damages for non-acceptance and non-delivery of goods. The Croudace line of cases was considered and Nettle AJ agreed with McGregor that it was illogical to confine consequential loss to the second limb of Hadley v Baxendale and then exclude it under the contract. His Honour utilised Sedley LJ’s words in the Hotel Services case to describe McGregor’s approach, “that the conception of consequential loss should be restored to ‘the natural meaning of which commercial and legal usage in exclusion clauses has long since robbed it’”.

Nettle JA was of the view that ordinary reasonable business persons would naturally conceive of ‘consequential loss’ in contract as everything beyond the normal measure of damages, such as profits lost or expenses incurred through breach. It was not correct to construe ‘consequential loss’ as limited to the second rule in Hadley v Baxendale. It was held that the ordinary and natural meaning of “consequential loss” intended by the parties in cl 8.9 was everything beyond the normal measure of damages, which is loss that every plaintiff in a like situation will suffer such as profits lost or expenses incurred through breach. Nettle JA concluded:

ordinary reasonable business persons would naturally conceive of ‘consequential loss’ in contract as everything beyond the normal measure of damages, such as profits lost or expenses incurred through breach.

The New South Wales Court of Appeal in Allianz Australia Insurance Ltd v Waterbrook at Yowie Bay Pty Ltd affirmed the Victorian Supreme Court’s decision in Peerles: the term “consequential loss” may include losses under the first limb of Hadley v Baxendale that arise “naturally” and in the ordinary context of the breach. Allianz was

69 (1854) 9 Ex 341; 156 ER 145.
70 [2008] VSCA 26 [90].
71 [2008] VSCA 26 [90].
72 [2008] VSCA 26 [93].
granted leave to appeal the Supreme Court decision, *Waterbrook at Yowie Bay Pty Limited v Allianz*74. Under section 18B of the Home Building Act 1989 (NSW) every residential contract has implied in it certain statutory warranties, and a contract insuring residential building work must insure against the risk of loss that may arise out of a breach of the statutory warranty. Neither the statutory warranties nor the statutory insurance rights can be excluded or restricted. At issue in *Waterbrook at Yowie Bay Pty Limited v Allianz* in this context was the exclusion clause in Allianz’s insurance policy covering the building work done by Waterbrook. The clause stated in part: “The insurer should not be liable for any claim for loss or damage: (10) For loss of use and/or consequential loss of any other kind arising directly or indirectly out of any event listed in the Building Owner’s indemnity, except as provided in subclause (5).” In the Supreme Court, McDougall J held that the relevant measure of damages reflected the first limb in *Hadley v Baxendale*. His Honour adopted the approach in *Environmental Systems Pty Ltd v Peerless Holdings Pty Ltd* that some ‘consequential loss’ may well fall within the first limb. A majority of the new South Wales Court of Appeal agreed with McDougall J that limitations on the entitlement to indemnity in the policy were void due to inconsistencies with the Home Building Act.

### 4.3 New Zealand

In the High Court decision, *Oceania Furniture Ltd v Debonaire Products Ltd*75 there was no binding authority in New Zealand on the meaning of ‘consequential’ losses. Clifford J discussed the two views and noted that the highest courts in England and Wales and Australia have not yet considered the issue. His Honour preferred the Victorian Court of Appeal’s approach in *Peerless*, which was to consider the ordinary commercial meaning of ‘consequential losses’ in the context of the particular contract. The meaning of the terms ‘indirect’ and ‘consequential loss’ was in Clifford J’s view clear from looking at those terms within the context of the particular contract entered into by Oceania and Debonaire. On the basis of the Australian view, ‘consequential loss’ would include everything beyond normal loss, and would include lost profits and expenses. In this case, the ordinary and natural meaning of the exclusion of liability for ‘indirect and consequential losses’ covered all losses other than those arising directly from, or immediately associated with, Oceania’s obligations.

### 4.4 The desirable approach?

In the three jurisdictions discussed above the approach that will be adopted by the courts is uncertain as in all cases there has not been a definitive decision from a higher court. The meaning of the words is not clear and as a matter of construction it will vary from contract to contract. Carter’s convincingly rejects both the Coudace and the McGregor approach76 and argues, inter alia, that on a consideration of the dictionary meaning77, the words are concerned with causation and have nothing to do with remoteness or the measure of damages. The courts in the discussed cases have determined the meaning of the words on a ‘once and for all’ basis. However, the function of a court is to construe

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74 [2008] NSWSC 1451.
77 The Oxford English Dictionary’s first two meanings of ‘consequential’ are ‘of the nature of a consequence or sequel’ and ‘of the nature of a consequence merely, not direct or immediate’.
each particular contract and a presumptive approach that the words have a particular meaning is not appropriate. The difficulties with these words highlight the importance of strict attention to the drafting of contract provisions to ensure that they say what is intended.

5 Conclusion

Fuller and Perdue's classification is no longer appropriate when viewed in light of the changed available monetary relief for contract damages since Attorney-General v Blake. A more appropriate classification is that of Tipping J in the New Zealand Supreme Court, where his Honour described the types of monetary relief in response to civil wrongs as:

- compensatory damages, disgorgement damages and restorative damages.
- Compensatory damages are loss based. Disgorgement damages are based on giving up a gain. Restorative damages are based on restoring to the plaintiff value transferred.

Compensatory damages are “the governing principle in contract” and these are the category of damages which the courts will generally award. In some cases the courts will emphasise the performance aspect of expectation damages but this should not be regarded as a different measure of contract damages. The principle of freedom of contract is subordinate to this governing principle and it is unlikely that there will be a radical change to the availability of agreed damages.

The three jurisdictions have adopted a similar approach to liquidated damages clauses and have readily adopted new terminology in their approach to liquidated damages. There are opposing views in relation to the meaning of ‘consequential’ loss in an exception clause. Parties do not enter their own contracts on the basis of what the words mean in other contracts, and each particular contract should be viewed on its facts. The meaning attributed in previous contracts should be irrelevant in deciding what an exception clause means. What is required is a ruling from the courts at the highest levels to ensure that the meaning is ascertained by construction of the contract rather than a presumptive approach.

78 [2001] 1 AC 268 (HL).
79 Premium Real Estate Ltd v Stevens [2009] 2 NZLR 384 (SC) 418 (Tipping J).