

## EXCLUSION OF INDIRECT/CONSEQUENTIAL LOSS – DO THE CLAUSES COVER WHAT YOU THINK? (2 ENTERTAIN VIDEO LTD V SONY DADC EUROPE LTD)

- There is no 'one size fits all approach' in relation to whether losses are classed as indirect/consequential.
- Losses which naturally flow from the breach will generally be considered to be direct losses – and are therefore unlikely to be caught by any exclusion of indirect and consequential loss.
- Parties may find that their exclusion clauses do not actually exclude the losses that they think they do – caution should be exercised when drafting any exclusion of indirect and consequential loss provisions.

### WHAT'S IT ABOUT?

The defendant (**Sony**) owned and occupied a warehouse which it used to store and distribute goods. Sony entered into a services agreement (**Agreement**) with the claimant (**2E**), pursuant to which Sony agreed to provide logistics services and store 2E's goods at the warehouse.

In 2011, the warehouse was broken into, looted and set on fire during the London riots. The warehouse, and the plant, stock and equipment contained within it, was completely destroyed by the fire. At the time this took place, 2E had approximately £40m worth of stock stored in the warehouse. The Court found that Sony had failed to take reasonable care to secure the warehouse and that it would therefore be liable to 2E – unless it was relieved of liability by the exclusion or limitation clauses.

The Agreement contained the following clause excluding indirect and consequential loss:

*"Neither party shall be liable... 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."*

One of the issues that the Court had to consider was whether this clause excluded Sony's liability for 2E's claim for loss of profits and business interruption. The Court found that the clause did not apply to those losses and so 2E's claim for loss of profits and business interruption succeeded.

### WHY DOES IT MATTER?

This case indicates that the courts are in favour of a traditional approach of interpreting "indirect and consequential loss", despite what may have appeared to have been a move away from this approach in the past.

Here, Sony argued that the clause excluded recovery of loss of profits and interruption to business, as these were "consequential loss". The Court therefore considered how "indirect and consequential loss" should be interpreted. It found that, whilst the meaning should not override the true construction of the clause, the words should be given their plain and natural meaning. This meant following the well-established rule set out in *Hadley v Baxendale* which categorises all losses as either being direct or indirect/consequential.

- 1 Direct losses are those which naturally result from the breach in the usual course of things.
- 2 Indirect losses are those which do not naturally result from the breach but arise from the special circumstances of the case.

The clause excluding indirect and consequential loss therefore only applied to losses which fell within the second limb of *Hadley v Baxendale*. In this instance, the loss of profits and business interruption suffered by 2E was found by the Court to be the direct and natural consequence of the fire i.e. within the first limb of *Hadley v Baxendale*, and the exclusion clause did not therefore apply.



## WHAT NOW?

We commonly see requests from contractors, sub-contractors and other parties to insert exclusions of indirect and consequential loss into contracts. The motivation for this can be insurance driven, as parties often look to exclude losses which are not backed by their insurances. It is also the norm for such clauses to be included in contracts relating to particular industry sectors.

This case however makes it clear that there is no 'one size fits all' approach. Whether a certain loss is categorised as direct or indirect/consequential will depend on the foreseeability of the loss and the circumstances of the particular case. It is not possible to say that a specific head of loss will always be either direct or indirect. It is common for parties when drafting such clauses to include examples of the kinds of losses that they are intending to be covered by the terms "indirect and consequential loss" – which was the case here. However, that approach can create uncertainty, particularly where the examples of types of loss that are given may actually fall within the definition of direct loss rather than indirect loss. Indeed in *2E v Sony*, the Court commented that the drafting of the clause was "unhelpful".

As a result, parties may find that their exclusion of indirect and consequential loss clauses do not actually exclude many of the losses that they believe they do; as was the case for Sony here. The reality is that such exclusion clauses may not actually limit much loss at all. The starting point is that losses which naturally flow from the breach will generally be construed as direct losses and are unlikely to be caught by such exclusions. When preparing contracts and negotiating such clauses parties should therefore exercise caution and ensure that their drafting is clear and specific so as to avoid unintended consequences.

## WHO TO CONTACT



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