

Direct or Indirect Loss?

Harminder Sandhu, managing director and head of Dispute Resolution at Hawkins Hatton provides a useful insight into the ability to limit a contractor's liability.

Contracts often contain a provision excluding liability for indirect and consequential loss but the distinction between direct and indirect/consequential loss can often be blurred. In particular, contractual exclusions of indirect loss do not always offer the protection that contractors envisage.

In so far as it is possible to draw a distinction between direct and indirect loss it is as follows:

1. Direct loss: a loss arising naturally, according to the usual course of things, from a breach of contract itself, and is therefore foreseeable and recoverable. Examples of direct losses could include physical damage, economic loss, loss of profits, damage to goodwill.
2. Indirect loss: such other loss that arises from a special circumstance of the case which the party breaching the contract was aware of at the time they made the contract, the loss would then have reasonably been in the contemplation of the parties as a probable consequence of the breach.

There is a common misconception that loss of profits and other financial losses will always be consequential loss and therefore potentially caught by an exclusion of liability. The scope of what the courts are willing to consider as direct losses is wide, what might be a direct loss in one case may be a consequential loss in another.

The above demonstrates that the distinction between direct and indirect loss is context specific and therefore contractual parties should give careful consideration to limitation of liability provisions in their contracts. Many parties when they are negotiating their contracts are often less concerned with provisions that only come into play if something goes wrong however, the above indicates that it is worth spending some time and effort on this to identify the type of losses that might arise if the contract goes wrong.

When negotiating a limitation of liability clause, it is important for contractors to specifically identify categories of losses that they are seeking to exclude and encompass this into a legally binding contract, for example loss of profit or loss of contracts. This is preferable to simply defining losses to be excluded as "indirect losses" and risk the Court deciding the loss is in fact a "direct loss". Other means of limiting a contractor's potential liability under a contract include agreeing a cap on liability (up to an insurable level) or seeking specific remedies such as liquidated damages.

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