[CONTRACT BREACHES]

Recovery position

Establishing the boundaries as to what losses can and can't be recouped in the event of a breach should form a crucial part of any contractual negotiations, counsels **Alan Ma**

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English law allows both direct losses and indirect losses to be recovered in the event of a breach of contract. Other losses are considered to be too remote that they cannot be recovered. The definition of what losses are recoverable can be traced back to the case of Hadley v Baxendale in 1854. The test laid down by the court was that the loss is not too remote if either (a) it naturally flowed from the breach (direct loss); or (b) it was within the reasonable contemplation of both parties at the time they made the contract (indirect loss, also known as consequential loss).

Under the principle of freedom to contract, parties are free to enter into agreement regarding the type of losses that are recoverable. It is not uncommon that suppliers seek to limit their liabilities by accepting only liability for direct losses and not indirect losses based on allocation of risks with buyers. This common feature is illustrated in GB Gas Holdings v Accenture (*Court Report, 14 October*) where the subject agreement excluded the supplier's liability for losses that are indirect or consequential. The Court of Appeal was asked to decide whether certain types of losses could be excluded. Applying the tests in Hadley v Baxendale, the courts ruled that (a) ex-gratia customer compensation; (b) additional wholesale gas charges; (c) additional borrowing charges; (d) additional staff costs; (e) unbilled charges written-off; and (f) costs of communicating with customers, including stationery expenses, all fell under direct losses and were recoverable. The judgement reflects a wide scope of direct losses that may be considered by the supplier as excluded liabilities when a contract is made.

Contracts that fail to reflect the intended allocation of risks create uncertainty for parties and should be avoided

Traditionally, companies adopt the use of exclusion clauses to define the extent of their respective liabilities. GB Gas Holdings and previous cases illustrate that courts are frequently approached as the guardian of the correct interpretation and application of exclusion clauses. Recent cases indicate that the courts consider the scope of duty an important factor when applying the test in Hadley v Baxendale. In Supershield Ltd v Siemens Building Technologies FE Ltd (*Law Update, 24 June*), the court ruled that the purpose of the contract and the scope of the contractual obligation form the basis of deciding remoteness. In Transfield Shipping v Mercator Shipping (*Court Report, 8 January 2009*), the House of Lords ruled that a party may not be liable even for foreseeable losses if they are not of a type for which that party has "assumed responsibility".

Contracts that fail to reflect the intended allocation of risks create uncertainty for the parties and should be avoided. Exclusion of liability clauses can be made clear by inclusion clauses that positively identify the recoverable heads of losses, which are generated from defined contractual scope of work and responsibilities. This can be achieved by way of including a schedule that allocates responsibility for the consequences of breach. The additional inclusion clause helps to avoid lengthy discussion of whether the losses are direct or indirect should things go wrong and to focus the parties' minds to ensure the identified responsibility is performed and fulfilled.