



COMMUNIQUÉ

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CONSEQUENTIAL DAMAGES

There have been various cases on this subject, and in one a man was going to be married, and his horse cast a shoe, and the smith having injured the horse in putting it on the man was late, and the lady refused to marry him; and it was held that the smith was liable for the damages resulting from the loss of the marriage. ...¹

This quote from a case heard on June 2, 1868 raises a number of questions, but the only one that this article will deal with is: what are consequential damages?

If your office burns down, there would be direct damages in relation to the loss of the building and the contents, but there would also be losses because the business is temporarily not operating. In addition, you would probably incur on-going overhead costs such as salaries, professional fees and office costs, notwithstanding that none of these costs are contributing to business income while the business is suspended.

Consequential damages are frequently excluded from contracts in the construction and engineering fields. If you are the person who cannot claim consequential damages, you may be out-of-pocket a considerable sum that cannot be recovered. If you are the person benefiting from a clause that excludes consequential damages, you are obtaining a potentially huge protection from loss. Consider the situation where a gas plant is destroyed by fire due to a design error. If the contract excludes consequential damages, then the person who made the design error may be liable for the loss of the plant, but is that person protected from a claim for the owner's loss of production from the gas plant during the period of reconstruction? Who bears the loss relating to the owner's overhead during the reconstruction period? What if the owner has further losses because it can no longer fulfil contracts for the supply of gas. Who bears that loss?

In a decision of the Alberta Court of Appeal in 1997,² that Court considered the following exclusion clause relating to consequential damages:

49 CONSEQUENTIAL DAMAGES: The Subcontractor will not be liable in any event for loss of anticipated profits, loss by reason of plant shutdown, non-operation or increased expense of operation of other equipment, or other consequential loss or damage of any nature arising from any cause whatever.

Note:

This *Communiqué* is provided as an information service and is a summary of current legal issues of concern to Construction Industry Clients. *Communiqués* are not meant as legal opinions and readers are cautioned not to act on information provided in this *Communiqué* without seeking specific legal advice with respect to their unique circumstances. Your comments and suggestions are most welcome. Please direct them to: ConstructionLaw@millerthomson.ca

¹ Unidentified case quoted, with disapproval, by Willes J. in *British Columbia and Vancouver's Island Spar, Lumber and Saw Mill Co. Ltd. v. Nettleship* [1861-73] All E.R. Rep. 340 (C.P.)

² *Synchrude Canada Ltd. v. Babcock & Wilcox Canada Ltd.* (1997), 51 Alta. L.R. (3d) 1 (C.A.)

The case dealt with the damages that Syncrude could recover as a result of three defective boilers designed and built by Babcock & Wilcox. The trial judge awarded \$6 million in relation to the cost of repairing the boilers. However, the trial judge also awarded \$4 million in relation to the extra cost of energy as a result of the boilers being inefficient, from the time of the defect becoming apparent to the date by which Syncrude could have had the boilers repaired. Babcock & Wilcox appealed this decision and argued that the \$4 million portion of the award to Syncrude was covered by the exclusion clause and not recoverable by Syncrude.

The Court of Appeal did not agree with the argument that anything beyond the direct cost of repairing the boilers was excluded by clause 49. In upholding the award to Syncrude, the Court of Appeal stated that damages should be calculated based on the difference in value between what was contracted for, and what was delivered. In making this calculation, the capitalized value of the extra energy expenses was taken into account. The court found that the additional cost of energy because the defective boilers were inefficient were not consequential to the damage incurred and were not excluded by clause 49.

The English Court of Appeal also considered consequential damages in a 1998 case which arose after an explosion destroyed a low pressure methanol plant.³ The process was licensed to the owner by the designer of the plant, who also constructed the plant through a subsidiary (referred to as the “Design-Builder”). The exclusion clause in the contract between the owner and the Design-Builder provided as follows:

... and in no event shall [the Design-Builder] by reason of its performance or obligation under this CONTRACT be liable ... for loss [of] anticipated profits, catalyst, raw-material and products or for indirect or consequential damages.

As a result of the plant exploding, the owner suffered a number of losses in addition to the cost to re-construct the plant. In particular, the owner claimed for (1) fixed costs and overheads incurred during the period from the explosion to the resumption of commercial production (referred to as “Overheads”) and (2) increased costs due to the re-constructed plant requiring more catalyst to operate than the original plant configuration (referred to as “Catalyst Cost”).

The English Court of Appeal concluded that losses which “‘clock up at once’ (namely the cost of idle men and plant etc.)” are direct losses and not consequential losses.⁴ Since the Overheads started to accrue as soon as the explosion occurred, they were considered direct and not consequential damages. The result was that the owner was entitled to pursue the claim for Overheads against the Design-Builder, notwithstanding the exclusion clause cited above. The Court stated that “[w]asted overheads incurred during the reconstruction of the plant, as well as profits lost during that period, are no more remote as losses than the cost of reconstruction.”⁵ This conclusion meant that the Overheads were not consequential damages and not excluded by the clause.

It is to be noted that the Court would have allowed the claim for lost profits during the reconstruction period, except for the specific exclusion in the clause cited above. This means that the general exclusion as to “consequential damages” was not broad enough to cover lost profits.

As for the Catalyst Cost, the Court of Appeal found this to be a valid claim for damages. On this point the Court said:

The extra cost claimed is the cost which has now become necessary in order to ensure and enable the plant safely to produce methanol in those quantities which the plant was supposed to. In other words, we would hold that this extra cost is akin to any other cost (such as an additional piece of

³ *Deepak Fertilisers and Petrochemical Corporation v. Davy McKee (London) Ltd.*, [1998] E.W.J. No. 3092; [1999] 1 Lloyd’s Rep. 387 (C.A., Civ. Div.)

⁴ *Supra*, note 3, at paragraph 89. The Court of Appeal followed another English Court of Appeal decision: *Croudace Construction Limited v. Cawoods Concrete Products Limited*, [1978] 2 Lloyd’s Rep. 55

⁵ *Supra*, note 3, at paragraph 90

plant or part) which achieved the same result. This could not be categorised as an indirect or consequential loss or damage nor could its cost be categorised as constituting a loss of profit.⁶

Consequential damages are not simply damages beyond direct property damages. Consequential damages are those damages foreseeable with special knowledge. When negotiating a contract the parties should consider those damages which they expect to be recoverable, and those which will be excluded, or limited, in the event of a loss. Exclusion clauses must be drafted clearly as courts will only enforce the narrow meaning of the words used to exclude or limit responsibility. Where the parties agree to exclude or limit damages for overheads, loss of profit, or additional costs to bring the project back to the level it was contracted to operate at (for instance the boiler specifications in the Alberta case or the use of catalyst in the English case, both discussed above) then those potential losses should be specifically and clearly excluded or limited by the terms of the contract. Relying on a general exclusion as to consequential damage will not exclude damages for all losses beyond direct losses and care should be taken in drafting consequential damage clauses.

The Construction Owners Association of Alberta (COAA) has prepared a standard form stipulated price contract for industrial projects⁷ which contains a clause limiting damages, including consequential damages to the limit of insurance carried. Not only does the clause limit damages for consequential loss, it also specifically limits damages for loss of use, loss of product, loss of revenue, overhead and profit and loss of any contract:

26.4 Notwithstanding anything else in this *Contract*, the *Contractor*, its *Subcontractors*, *Suppliers*, and their respective officers, directors, employees, consultants and agents shall not be liable to the *Owner*, or anyone claiming through or under it, whether by way of indemnity or by reason of breach of contract or in tort, including liability for negligence and breach of statutory duty, or on any other legal or equitable basis, for:

26.4.1 special or consequential loss or damage;

26.4.2 loss of use, whether complete or partial, of the *Work* or existing facilities of the *Owner* or third parties;

26.4.3 loss of product;

26.4.4 loss of revenue, overhead and profit; or

26.4.5 loss of any contract that may be suffered by the *Owner*,

except to the extent of amounts recoverable under a policy or policies of insurance required to be maintained by the *Contractor*, or provided by the *Owner*, pursuant to the provisions of this *Contract*, provided however that in the event of the failure by the *Contractor* to complete the *Work* by the *Contract Time* the liability of the *Contractor* under this GC 26.4 shall be limited only to the greater of the insurance recoverable and \$_____.

The COAA consequential damages clause can be used as a starting point for considering those damages which should be limited or excluded from a contract, depending on the underlying business deal. Any damages relating to a particular project that the parties wish to limit, or exclude, should be done so specifically in the contract terms.

⁶ *Supra*, note 3, at paragraph 92

⁷ For further information on the COAA and to obtain a copy of the standard form stipulated price contract, visit the COAA website at www.coaa.ab.ca

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