Chapter 5

Direct loss and/or expense

5.1 Definition

In most standard form contracts, the clauses which entitle the contractor to apply for additional money, as a result of disruption or prolongation, use the phrase 'direct loss and/or expense'. It is essential to understand the meaning of the phrase, otherwise neither the party claiming nor the party claimed against will be in a position to understand their rights. The term is used in SBC clause 4.23, IC and ICD clause 4.17, MW and MWD clause 3.6.3 and DB clause 4.20. It is also used in related subcontracts: SBCSub/C, SBCSub/D/C and DBSub/C clause 4.19, ICSub/NAM/C, ICSub/C and ICSub/D/C clause 4.16 and in other contracts in the JCT suite.

Other standard form contracts use similar phrases such as 'direct loss and/or damage' or 'direct loss and expense'. It is thought unlikely that the slight differences in expression will result in any radical difference in meaning. Government Conditions use different wording. GC/Works/1(1998), clause 46(1) refers to the contractor 'properly and directly' incurring any expense which results in regular progress being materially disrupted or prolonged. Clause 46(6) defines 'expense' as being money expended by the contractor. However, it makes clear that it does not include a sum expended or a loss incurred by way of interest or finance charges. Loss and expense may be thought of as two sides of the same coin, but it is open to debate whether all, or indeed any, instances of loss would be covered by the word 'expense'. The point is examined below. Although expressed in varied ways, all the phrases used in the standard form contracts make clear that they refer to losses and/or expenses which the law regards as 'direct' in contrast with, and excluding, losses and/or expenses regarded as being indirect or too remote. This is a distinction of particular importance which will be considered later. The phrase 'direct loss and/or damage' has been judicially considered.[1]

> 'what is its usual, ordinary and proper meaning in the law: one has to ask whether any particular matter or items of loss or damage claimed have been caused by the particular matter. . . . if it has been caused by it, then one has to go on to see whether there has been some intervention or some other cause which prevents the loss or damage from being properly described as being the direct consequence of the [matter].'[2]

[1] In *Wraight Ltd v P H & T (Holdings) Ltd* (1968) 13 BLR 27.
[2] (1968) 13 BLR 27 at 33 per Megaw J.

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Reference to 'direct loss and/or expense' or similar phrases is clearly the same as a reference to damages claimable at common law and should be thought of as equivalent in terms of the measure of damages and the standard of proof required.[3]

The word 'loss' is often used to encompass, not only money which should have, but has not, been received, but also money which should not have, but has, been spent. Thus, the contractor is entitled to claim its losses or its expenses or both together. But the use of both words, 'loss' and 'expense' suggests a distinction between the two expressions. If that is correct, the use of the dual phrase gives the contractor two separate avenues of claim based on the same grounds:

- losses actually incurred as a direct result of particular circumstances
- expenditure actually occurring as a direct result of the same circumstances.

This is important, because although 'loss' may be held to encompass both loss and expense, 'expense' is not wide enough to include loss: 'the primary meaning of the word "expense" is actual disbursement'.[4]

5.2 Direct v indirect

It is important to understand the difference between direct and indirect (or consequential) loss or damage. A party in breach is not liable to pay all the damage suffered by the injured party. The courts limit the damages to what is reasonable in the circumstances by ruling out all damage said to be too remote. It is only the remoteness of, or the entitlement of a party to, damages which is considered here, the amount of damages is a separate issue which will be considered later. The rule has been stated as follows:

> '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 the breach of it. Now, if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated.'[5]

The rule is said to have two 'limbs'. The first limb refers to damages 'arising naturally'. Such damages are often referred to as 'general damages'. They are the kind of damages that anyone would expect to be the result of the breach. The second limb refers to damages 'in the contemplation of both parties at the time they made the contract'.

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[3] See *F G Minter Ltd v Welsh Health Technical Services Organisation* (1980) 13 BLR 7 CA.
[4] *Chandris v Union of India* [1956] 1 All ER 358 at 363 per Lord Justice Hodson.
[5] *Hadley v Baxendale* (1854) 9 Ex 341 at 354 per Alderson B.

These kinds of damages depend upon the knowledge of the parties of special circumstances and they are often referred to as 'special damages'. For example, suppose Ms A buys a car from Acme Used Cars and drives it away intending to use it immediately to drive to Southampton; there to start a pre-booked cruising holiday. Further, suppose the car breaks down on the way to Southampton so that Ms A does not reach the ship in time before its departure. Ms A can certainly claim from Acme the cost of necessary repairs to the car, but she cannot claim the cost of the lost holiday, because Acme knew nothing of the projected holiday or the consequences of a mechanical breakdown. If all those facts had been made known to Acme before or at the time of the sale contract for the car, Ms A might have been able to claim the cost of the holiday also. In practice, it is unlikely that Acme would accept such a liability and there may well be clause in its sale contract to deal with that eventuality, but the principle remains good.

A useful explanation of this decision and of the authorities generally was given in *Victoria Laundry (Windsor) v Newman Industries, Coulson & Co*.[6] It took the form of propositions which may be summarised as follows:

(1) The purpose of damages is to put the injured party in the same position, so far as money can, as if its rights had been observed, but to pursue that purpose would provide the party with a complete indemnity and it is considered to be too harsh.
(2) The injured party may only recover loss reasonably foreseeable at the time of the contract.
(3) Foreseeability depends on the knowledge of the party committing the breach.
(4) Knowledge is of two kinds: (a) all reasonable people are assumed to know the kind of loss which is liable to result from a breach in the ordinary course of things; (b) actual knowledge of special circumstances which may cause greater loss.
(5) The contract breaker will be liable provided that, if it had asked itself, it would have concluded, as a reasonable person, that the loss was liable to result from that breach.
(6) It is enough if the loss could be seen as likely to result.

These propositions were considered by the House of Lords in *The Heron II*.[7] Although they rejected proposition 6 as being too broad, they did not agree the test which should be substituted. Taking their Lordships opinions together, *it is enough if the loss was a serious possibility* appears to be a reasonable consensus. The crucial point which lies at the foundation of the rule in *Hadley v Baxendale*, is the knowledge possessed by the contract breaker at the time the contract was entered into. The point is whether the party had just the ordinary knowledge of an average person in that situation or whether, if the party had considered the matter, its special knowledge would have led it to the conclusion that greater (or perhaps less) than the ordinary loss would result from the breach.

It seems that it is enough if the type of loss is within the reasonable contemplation of the parties even though the *extent* of such loss is far greater than they could have

[6] [1949] 1 All ER 997 at 1002 per Asquith LJ.
[7] *Koufos v Czarnikow Ltd (The Heron II)* [1969] 1 AC 350.

contemplated. The classic case is *Parsons (Livestock) Ltd v Utley Ingham & Co Ltd*.[8] There, a bulk food storage hopper was installed, but the ventilator was closed and as a result the pig-nut feed became mouldy. A herd of pigs became ill with a serious disease and many of them died. The court held that it was foreseeable that in these circumstances the pigs would have suffered illness although the consequences would not have been expected to be so serious. However, the parties would have contemplated that if the hopper was defective, serious illness and death was a serious possibility.

5.3 Exclusion of consequential loss

In theory, the differences between types of loss are easy to understand. In practice, these concepts often lead to real difficulties of interpretation. In *Saintline Ltd v Richardsons, Westgarth & Co Ltd*,[9] the court considered the difference between direct and consequential loss or damage. The manufacturers of engines for a ship were in breach of contract and the ship's owners brought an action for damages including loss of profit, wages and storage costs and other fees. The contract contained a clause providing that a manufacturer's liability should not 'extend to any indirect or consequential damages whatsoever'. The court held that all these items were recoverable as damages, because they were a direct and natural consequence of the breach of contract. In giving judgment the judge said:

> 'What does one mean by "direct damage"? Direct damage is that which flows naturally from the breach without other intervening cause and independently of special circumstances while indirect damage does not so flow. The words "indirect or consequential" do not exclude liability for damages which are the direct and natural result of the breaches complained of . . . What the clause does do is to protect the respondents from claims for special damages which would be recoverable only on proof of special circumstances and for damages contributed to by some supervening cause.'[10]

Croudace Construction Ltd v Cawoods Concrete Products Ltd[11] considered the same point. Croudace was the contractor for the erection of a school and it contracted with Cawoods for the supply and delivery of masonry blocks. Cawoods had attempted to restrict its liability by including a term in the contract that

> 'We are not under any circumstances to be liable for any consequential loss or damage caused or arising by reason of late supply or any fault, failure or defect in any materials or goods supplied by us or by reason of the same not being of the quality or specification ordered or by reason of any other matter whatsoever'.

Such clauses usually only exclude liability for damages under the second limb of *Hadley v Baxendale* and so it proved in this case.[12] Croudace made a claim against

[8] [1977] 2 Lloyds Rep 522.
[9] [1940] 2 KB 99.
[10] [1940] 2 KB 99 at 103 per Atkinson J.
[11] (1978) 8 BLR 20.
[12] *British Sugar plc v NEI Power Projects Ltd* (1987) 87 BLR 42.

Cawoods for breach of contract alleging late delivery and defects in materials. They sought to recover loss of productivity and various costs arising out of delay. The question which went before the Court of Appeal was whether such damages were to be regarded as 'consequential' loss. The Court held that the exclusion of consequential loss or damage did not apply to loss resulting in the ordinary course from late delivery of, and defects in, materials which were heads of direct loss. The Court quoted with approval: 'on the question of damages, the word "consequential" has come to mean "not direct". . .'[13] An example of a case where the damage was held to be too remote is *Balfour Beatty Construction (Scotland) Ltd v Scottish Power plc.*[14] Scottish Power had contracted to supply temporary power to Balfour Beatty's concrete batching plant. Scottish Power was held to be in breach of contract after an interruption in the power supply. The facts were that Balfour Beatty was in the process of constructing an aqueduct by the system of continuous concrete pour. Therefore, when the supply was interrupted, the aqueduct had to be demolished and work re-commenced. A claim for the cost of the demolition and re-building failed, because the House of Lords held that Scottish Power could not be presumed to know of the practice of continuous pour construction. It was said:

> 'It must always be a question of circumstances what one contracting party is presumed to know about the business activities of the other. No doubt the simpler the activity of the one, the more readily can it be inferred that the other would have reasonable knowledge thereof. However, when the activity of A involves complicated construction or manufacturing techniques, I see no reason why B who supplies a commodity that A intends to use in the course of those techniques should be assumed, merely because of the order for the commodity, to be aware of the details of all the techniques undertaken by A and the effect thereupon of any failure of or deficiency in that commodity. Even if the Lord Ordinary had made a positive finding that continuous pour was a regular part of industrial practice it would not follow that in the absence of any other evidence suppliers of electricity such as the Board should have been aware of that practice.'[15]

Croudace Construction Ltd, *Saintline Ltd* and *Wraight Ltd* were considered with approval by the Court of Appeal in *F G Minter Ltd v Welsh Health Technical Services Organisation*,[16] which confirmed that, in JCT contracts, what is recoverable as direct loss and/or expense is the same as the damages recoverable at common law for breach of contract.

Although some of these cases are expressly referable to JCT contracts, it is probable that the principles also apply to claims under other contracts where phrases similar to 'loss and/or expense' are used. In *Robertson Group (Construction) Ltd v Amey-Miller (Edinburgh) Joint Venture*[17] the court, after listening to many submissions regarding remoteness of damage, considered that the phrase 'all direct costs and directly incurred losses' permitted the recovery of reasonable sums by way of general corporate overheads and profit. In that instance, the phrase occurred in a letter which

[13] *Millar's Machinery Co Ltd v David Way & Son* (1934) 40 Comm Cas 204 at 210 per Maugham LJ.
[14] (1994) 71 BLR 20.
[15] *Balfour Beatty Construction (Scotland) Ltd v Scottish Power plc* (1994) 71 BLR 20 at 29 per Lord Jauncey.
[16] (1980) 13 BLR 7.
[17] [2005] ScotCS CSOH 60.

was intended to form a temporary contract while the terms of a contract under JCT conditions were finalised.

However, it should be noted that, because the recovery of direct loss and/or expense is a procedure under a specific term of the contract, the recovery of certain heads of claim may be permitted under the express contract terms which might not be recoverable as a claim for damages at common law.[18]

[18] Some of the grounds for such contractual claims are not breaches of contract as an examination of the 'Relevant Matters' in SBC clause 4.24 will confirm (see Chapter 13, Section 13.1.5).