In *Polypearl Ltd v E.ON Energy Solutions Ltd* [2014] EWHC 3045 (QB) the High Court held that an exclusion clause failed to exclude direct loss of profit.

This case is a useful reminder that exclusion clauses must be expressed clearly and without ambiguity. The clause must be drafted to cover the obligation or liability which it is sought to exclude or restrict. The case also provides useful insight as to the difference between direct and indirect loss, and how claims for loss of profit can fall into both categories.

**Exemption Clauses**

Although a total exclusion of liability is today, due to legislative intervention (Unfair Contract Terms Act, 1977 and Unfair Terms in Consumer Contract Regulations, 1999), relatively uncommon, exclusion clauses are frequently found in written contracts (and in particular construction contracts). Such clauses seek to exclude or restrict a party’s right to recover certain types of losses. Typically, direct and / or indirect loss, but what is the distinction?

**Direct and Indirect Loss**

The well known case of *Hadley v Baxendale* [1854] 9 EXCH 341 categorises the distinction between direct and indirect loss as follows:

(i) Direct loss: loss arising naturally, according to the usual course of things, from the breach of contract; and

(ii) Indirect loss (also known as consequential loss): loss that does not arise naturally in the course of events, but was still in the reasonable contemplation of the parties at the time the contract was entered into.

If the loss falls outside these two limbs, then it will be considered too remote and a claimant will not be able to recover it.
Loss of Profit

There has been a considerable amount of case law in recent years regarding exclusion clauses: whether or not they have been incorporated into the contract and if so what losses they are actually excluding. A common mistake people make is thinking that loss of profit and other financial losses are always indirect loss. As a matter of general law, a claim for loss of profit may be either a direct or indirect loss, depending on the circumstance.

In *McCain Foods GB V Eco Tech (Europe) Limited* [2011] EWHC 66 (TCC) McCain purchased a system from Eco Tech that removed hydrogen sulphide from the biogas so that it could be used to generate heat and electricity from which McCain could generate revenue. The system was defective and McCain claimed damages for breach of contract including loss of profits. The contract excluded liability for "indirect, special, incidental and consequential damages". Eco-Tech claimed that the loss of profit was indirect and excluded under the contract. It was held that the loss of profits arose naturally in the normal course of things and were therefore deemed direct and not excluded under the contract.

However, in *Elvanite v AMEC* [2013] EWHC 1643 (TCC), Elvanite engaged AMEC to make a planning application. The application was made several months late and Elvanite claimed damages for breach of contract, including loss of profit resulting in the failure to sell the site. The contract excluded liability for "any consequential, incidental or indirect damages". AMEC argued that the loss of profit claimed by Elvanite constituted consequential or indirect damage and that had been therefore excluded. Coulson J considered that the reference to "indirect damages" meant losses recoverable under the second limb of *Hadley v Baxendale* and that the contractual obligations of the parties will ultimately dictate whether or not a claim for loss of profit would fall within that limb. In this particular case AMEC’s contractual obligation was to use reasonable skill and care in its completion of the planning application and that any loss of profit for future sales would be deemed to be indirect because it would be contingent upon the claimant’s intention to sell the site on to a third party. A distinction was drawn between this situation and a contract for sale of profit making equipment where loss of profit would be a direct loss (as above).

The distinction has been considered again in the case of *Polypearl Ltd v E.ON Energy Solutions Ltd* [EWHC] 2014 3045.

"Exception clauses must be drafted to cover the obligation or liability which it is sought to exclude or restrict"
Polypearl
In Polypearl, the parties entered into a contract for the supply of cavity wall bead and adhesive. Polypearl alleged that E.On had agreed to purchase a certain amount of the product, but only purchased some of this amount resulting in a shortfall. Polypearl claimed that E.On was in breach of contract in failing to purchase the shortfall and claimed damages, including circa £2m loss of profit. E.On argued that loss of profit was an indirect loss and therefore excluded under the contract.

The contract stated: "10.1 *Neither party will be liable to the other for any indirect or consequential loss, (both of which include, without limitation, pure economic loss, loss of profit, loss of business, depletion of goodwill and like loss) howsoever caused (including as a result of negligence)...*

and

"10.7 Subject to the above, the aggregate liability of each party under this agreement for any damage or direct loss howsoever caused (other than death or personal injury caused by the indemnifying party’s negligence) will (save in respect of E.On’s obligation to pay the charges or Polypearl’s obligation to reimburse any of the charges) be limited to £1,000,000)"

Decision
The court held that the loss of profits claim was a direct loss. The exclusion clause was ambiguous and therefore did not exclude liability for direct loss of profits. However, the limit clause was clear and unambiguous and therefore the £1m limit for direct loss would apply.

The reasoning in the case
Judge Behrens held that a claim for loss of profits may be either a direct or indirect loss. It will be a direct loss if, at the time the contract was entered into, it was likely to result from the breach in question. It will be indirect if there are special circumstances known to the contract breaker at the time of the contract such that a breach would be liable to cause more loss. The judge, therefore agreed with the claimant’s submissions that the most obvious and likely loss from a breach of obligation to purchase products is a loss of profit. He added that this construction of the contract is more logical in terms of common business sense as it seems unlikely that a business man would wish to exclude his ability to claim for this direct loss. Judge Behrens did, however, state that it would be possible to conceive of other claims of loss of profit.
arising from other breaches which would be categorised as indirect, but did not elaborate on this further.

In considering the application of the exemption clauses the Judge Behrens referred to the recent judgment in *Fujitsu Services td v IBM United Kingdom Ltd [2014] EWHC 752 (TCC*), stating that whether an exclusion clause applies is still a question of construction. The court, therefore, held the words "loss of profits" in the exclusion clause was limited to the preceding words "indirect or consequential loss" and acted as an explanation of what could be an indirect or consequential loss, not an attempt to place a form of direct loss, the loss of profit, in the indirect category. If the parties had intended to abandon a claim for direct loss of profits, clear language should have been used in the contract and, if all loss of profits claims were to be deemed indirect, the parties could have easily included such a term.

**Implications and drafting points**
This case is a useful reminder that exception clauses must be expressed clearly and without ambiguity. The clause must be drafted to cover the obligation or liability which it is sought to exclude or restrict. As loss of profit can be categorised as direct or indirect loss, if parties intend to exclude all claims for loss of profit, the clause must clearly express words to that effect. Furthermore, this decision indicates that a court will be reluctant to infer that a party has abandoned this legal right without clear express words to the contrary.

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