THINK TWICE, DRAFT ONCE: CONSEQUENTIAL AND SPECIAL DAMAGES IN EXCLUSION CLAUSES

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Commercial agreements commonly include a provision for a customer's waiver of, or limitation on the right to pursue, consequential or special damages. Since such provisions are nearly ubiquitous, they may not routinely attract the attention of in-house counsel or others responsible for settling the terms of a business's contract with a service provider or other supplier. These exclusion clauses do, however, warrant real focus and attention because they may have a material impact on damages that may be recovered by the customer should the counterparty fall short on its commitments under the contract, or wrong the customer in some other way over the course of the contractual relationship.

Common language for exclusion of damages clauses

Exclusion of damages clauses appear in any number of forms. They are designed to allocate risk. As the Court of Appeal for Ontario explained in *Chuang v. Toyota Canada Inc.*, a beneficiary of an exclusion clause "contracts out of the obligation that would normally follow from the breach of the contract and places [at least some aspect of] the risk of the breach on the other party to the contract. The extent to which the risk of breach is reallocated to the non-breaching party will depend on the language of the specific exclusion clause considered in the context of the entire agreement."[1] Here are three examples:

A. *Neither party will be responsible or held liable for any consequential, indirect or special losses or damages.*[2]
B. *In no event shall the seller be liable for any incidental, consequential or special damages.*[3]
C. *In the event of the termination, [Party X] shall not be liable for any losses, damages and/or expenses of any kind whatsoever, suffered or incurred by you directly or indirectly.*[4]

It is essential for those negotiating commercial agreements incorporating provisions like these to have a strong understanding of what each of the terms "consequential," "indirect," "special losses or damages", "incidental" and "direct" means in the context of risk allocation.

Types of damages and their recovery under Canadian contract law and in tort

Fundamentally, damages are available to a party suffering from a breach of contract to put the party, so far as money can do, in the position the party would have been in had their rights been respected. The victim of a tort is entitled to damages that revert the victim to the position that they were in before suffering the wrong. As a starting point, damages are recoverable where they: "(i) were reasonably foreseen or contemplated by the parties; (ii) are causally connected to the breach; and (iii) are not too remote."[5] Over the years, courts have variously ascribed labels to subcategories of these damages.

Direct versus consequential damages

The term "consequential damages" is generally relevant in the context of damages for breach of contract.

Courts have understood the seminal contract case of *Hadley v Baxendale*[6] as creating two branches of damages capable of recovery. First, objectively foreseeable damages, also known as direct damages. These are losses that arise naturally in the usual course from the breach of the contract or that were reasonably in the contemplation of both parties to be the result of the breach. And second, special circumstances damages which are losses in addition to objectively foreseeable damages. This second branch can be known as consequential damages, which is and of itself confusing, because they are no more a consequence of the breach of contract than direct damages. In any event, recovery of this second type of damage is possible if the special circumstances were known to the breaching party. Recovery also turns on whether the damage pertains to the kind of losses the parties would reasonably contemplate flowing from the breach of contract in the special circumstances in which the contract was made.[7]

While the Supreme Court of Canada adopted the principles from *Hadley in Fidler v Sun Life Assurance Co. of Canada*[8] and Canadian jurisprudence tends to understand *Hadley*'s two branches of damages, consequential damages can still be considered an ambiguous term among courts and commentators alike.[9] As a result, "lawyers should not assume that consequential losses suggest a degree of causation, intervention of other causes, or that they refer to losses suffered beyond the immediate breach."[10]

Importantly, consequential damages can turn out to comprise a large loss leading to real regret on the part of the non-breaching party if such damages were excluded or limited in any way by contract. For instance, the direct damage for breach of a supply contract can be the price paid for the goods that were not supplied, plus any additional cost necessary to obtain the goods from another supplier. But the consequential damages of a breach of the supply contract could be determined to include, among other things, lost profits on the sale of some other product into which the non-breaching party was going to incorporate the purchased goods, and the value of a relationship lost because the non-breaching party did not have the purchased goods at the expected time.

Special Damages

Special damages have the potential to add another layer of confusion given the broad use of the term.[11] Special damages are usually referenced in the context of damages in tort, understood as pecuniary loses suffered which can be easily calculated.[12] For example, special damages may include the cost of renting replacement equipment in a factory on a temporary basis if, through negligence, a contractor damages a piece of equipment in the factory while carrying out some work. Ordinary damages (that is, "general damages") will cover the expense of rectifying the damage to the equipment and compensation for the impact of the incident on the business, amounts that often are not easily quantifiable.

No Canadian court has mapped the term "special damages" onto either of the branches of damages described in *Hadley*. Despite this, there are examples of Canadian courts using the term "special damages" in the context of a contractual breach.[13] As such, excluding special damages from recovery may unintentionally prevent a party from recovering damages that plainly fall within the first branch of the *Hadley* damages tree, the recovery of which would generally be uncontroversial.[14]

Settling exclusion of damages provisions

Parties negotiating a commercial agreement will have competing concerns when it comes to provisions of a contract dealing with the exclusion of damages, just as they will with other key terms of the agreement. Where both the contract price and the risk of harm to the customer is low, it may be eminently reasonable for a service provider to insist on the customer's damages being limited to the contract price. On the other end of the spectrum, where a customer is paying a premium for high-value services critical to its business, it may be fair for damages to not be limited in any way. In between, there is room for reasonable counsel to disagree on the appropriate allocation of risk in the circumstances. In the end, some limitation on damages may well find its way into the final draft. Entering into negotiations with a full understanding of terms like "consequential damages" and "special damages" goes a long way to insuring that the contract binding the parties strikes the right bargain.

[1] *Chuang v Toyota Canada Inc.*, 2016 ONCA 584 at para 32, citing *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)*, 2010 SCC 4 [*Chuang*].
[2] Joseph Grignano, "Not So Inconsequential… Waiving Recoveries Related to Consequential Damages", February 18, 2016, *The Six-Minute Commercial Leasing Lawyer 2016*, at page 8-2.
[3] See Appendix in *IPEX v Lubrizol*, 2012 ONSC 2717, where this term was added to the seller's warranties.
[4] Language taken from *Chuang* at paras 17 and 33.
[5] John F. Clifford, Charlotte Conlin and Graham Bevans, "The Uncertain Consequences of Waiving Consequential Damages" at 6-7. Please note that this paper can be found online here as well as in the Canadian Business Law Journal (2020), 63 C.B.L.J. 178.
[6] [1854] EWHC Exch J70.

[7] Clifford, Conlin & Bevans at 7; see also Grignano at 8-4 - 8-5.
[8] 2006 SCC 30 at para 27.
[9] Clifford, Conlin & Bevans at 7, 10, 13. See for instance *Agfaphoto Canada Inc. v Overwaitea Food Group Ltd.*, 2008 BCSC 1287 where the court used the term consequential damages in terms of its causal relationship to the breach of contract.
[10] Clifford, Conlin & Bevans at 10.
[11] *Hope Hardware and Building Supply Co. Ltd. v Fields Stores Limited*, 1978 CanLII 254 (BCSC) at paras 36 and 46, varied on appeal *Hope Hardware and Building Supply Co. Ltd. v Fields Stores*, 1980 CarswellBC 615 (CA) [*Hope Hardware*].
[12] *Hope Hardware* at para 39; Clifford, Conlin & Bevans at 14.
[13] See *Star Line Inc. v Hydro-Mac Inc.*, 2008 NLTD 73, *New Brunswick Power Corp. v. Westinghouse Canada Inc.*, 2008 NBCA 70; see also Clifford, Conlin & Bevans at 14-15.
[14] Clifford, Conlin & Bevans at 15-16.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.