
CONSEQUENTIAL DAMAGES

- 1.1 Most limitation-of-liability provisions exclude consequential damages, but the term *consequential damages* is confusing. After considering the scope of limitation-of-liability provisions generally, this section describes problems with excluding consequential damages and suggests alternatives, including contract provisions that address the issue clearly. This analysis applies to common-law jurisdictions generally, and so do the proposed solutions.

A Variety of Exclusions

- 1.2 In common-law jurisdictions, it's routine for contracts to seek to exclude—often under the heading *Limitation of Liability*—certain types of damages. Here's an example:

In no event shall a party have any liability to another party for any punitive damages, lost profits, diminution of value, consequential damages, special damages, incidental damages, indirect damages, exemplary damages, or other similar unforeseen damages.

- 1.3 A single example doesn't give one a sense of what one might find in limitation-of-liability provisions. In half an hour on the U.S. Securities and Exchange Commission's EDGAR system, this author compiled a list of 31 elements he found in limitation-of-liability provisions. See *Limitation-of-Liability Overkill*, Adams on Contract Drafting (5 Mar. 2020), <https://www.adamsdrafting.com/limitation-of-liability-overkill/>. The sheer number suggests that drafters improvise what they include in limitation-of-liability provisions.

What Contract Damages Can Be Recovered

- 1.4 Furthermore, it might be unclear what a given element means. A broader survey is beyond the scope of this manual, so this section addresses the meaning of the element seen most often in limitation-of-liability provisions, namely *consequential damages*.
- 1.5 To understand how best to address consequential damages in contracts, a good starting point is the nineteenth-century English case *Hadley v. Baxendale* (1854), 156 E.R. 145, 9 Exch. 341 (Eng. Exch.), which established what damages can be recovered for breach of contract. The rule in *Hadley* is commonly described as having two “branches.” First, contract damages recoverable on breach of a contract always include those losses that would arise normally and naturally as the result of that breach. And second, recoverable contract damages also include any other losses arising from the special circumstances of the nonbreaching party, if those special circumstances were communicated to the breaching party when the contract was made and so were within the contemplation of the parties as a probable consequence of breach of that contract.
- 1.6 The term *direct damages*, also known as *general damages*, is best understood as equivalent to damages recoverable under the *Hadley* first branch. That's why *Black's Law Dictionary* says they are “Damages that the law presumes follow from the type of wrong complained of.”

Consequential Damages Is Confusing

- 1.7 Many courts have equated consequential damages with the *Hadley* second branch, although that case didn't use the phrase *consequential damages*. See Glenn D. West & Sara G. Duran, *Reassessing the “Consequences” of Consequential Damage Waivers in Acquisition Agreements*, 63 Business Lawyer 777, 791 (2008) [referred to below as *West & Duran*].

- 1.8** But *Black's Law Dictionary* offers a different meaning, saying that consequential damages—which it says are also termed *indirect damages*—are “Losses that do not flow directly and immediately from an injurious act but that result indirectly from the act.” See also 11 *Corbin on Contracts* § 56.6 (“The term ‘consequential damages’ has often been used with respect to harm suffered as a ‘consequence’ of the breach of duty, but not as a direct and immediate and foreseeable consequence.”). Because it has two possible meanings, *consequential damages* exhibits lexical ambiguity (see x.x). This meaning makes the issue one of causation, not foreseeability. See John F. Clifford, Charlotte Conlin & Graham Bevans, *The Uncertain Consequences of Waiving Consequential Damages*, 63 *Canadian Business Law J.* 178, 190–191 (2020) [referred to below as *Clifford, Conlin & Bevans*].
- 1.9** Further complicating matters, many of those that seek to exclude consequential damages assume that otherwise the nonbreaching party could recover remote damages, namely damages that were beyond the contemplation of the parties when they entered into the contract. (The example in 1.1 ends with *or other similar unforeseen damages*, which suggests that the entire provision seeks to exclude only remote damages.) But the law doesn’t allow for recovery of remote damages, so consequential damages don’t compensate a buyer for remote damages. See *West & Duran*, at 783–84. That’s why *Black's Law Dictionary* offers as the definition of *remote damages* “Damages that are so uncertain to occur that they will not be awarded.” Attributing an illegitimate meaning to *consequential damages* doesn’t make it any more ambiguous, as courts should be unwilling to recognize that meaning, but it does make *consequential damages* more confusing.
- 1.10** Some limitation-of-liability provisions pile on the exclusions in a way that adds to the confusion. A contract might exclude both special damages and consequential damages (see the example in 1.1), even though U.S. courts generally treat *consequential damages* and *special damages* as synonyms. See *West & Duran*, at 788. (Adding to the confusion, *special damages* has a different meaning when used as a tort-law term of art. See *Clifford, Conlin & Bevans*, at 198.)
- 1.11** And more broadly, if a contract excludes both direct damages (see 1.6) and indirect damages (see 1.8), that could lead to a fight over whether all damages are excluded or whether the contract is void. See, e.g., *Innovate Technology Solutions, L.P. v. Youngsoft, Inc.*, 418 S.W.3d 148, 151 (Tex. App. 2013).
- 1.12** Given the confusion, it’s not surprising that courts acknowledge it’s unclear what *consequential damages* means. See, e.g., *Applied Data Processing, Inc. v. Burroughs Corp.*, 394 F. Supp. 504, 508 (D. Conn. 1975).

Alternatives to Confusion

- 1.13** Given the problems with conventional provisions excluding damages, drafters should consider instead addressing the parties’ concerns more clearly. You have different options to choose from.
- 1.14** A starting point would be to exclude damages that aren’t reasonably foreseeable (see 1.9). *West & Duran*, at 806, endorses this approach: “Instead of waiving ‘consequential’ damages, buyers should seek waivers of ‘remote’ or ‘speculative’ damages.” This manual proposes the provision below. It states what a court would likely conclude anyway, but it might prevent confused parties from getting into a fight over this issue.

Neither party will be liable for breach-of-contract damages that the breaching party could not reasonably have foreseen at the time of breach.

- 1.15** If that doesn't satisfy the seller—it wants to exclude some otherwise recoverable damages—the parties could agree to an absolute cap on damages as an alternative to engaging in the uncertain exercise of excluding certain types of damages.
- 1.16** If a seller nevertheless wants to limit certain types of damages, it might be simpler to describe what damages are included rather than those that are excluded. In the case of sale of goods, presumably you would articulate, without using those terms of art, expectancy damages (the value of the thing promised less the value of the thing delivered) and the difference between the cost of cover (purchase of substitute goods) and the contract price, with perhaps a cap built in.
- 1.17** If you also, or instead, want to exclude damages, don't rely on the confusing phrase *consequential damages*. Instead, make it clear what you mean. Of the two meanings of *consequential damages*, the one associated with the *Hadley* second branch (see 1.7) is more productive, in that it expresses a clear expansion from the *Hadley* first branch. And to express that meaning, it makes sense to use instead of *consequential damages* the phrase that makes it clear what's at issue—*special circumstances*. Using instead the meaning of *consequential damages* that equates it with indirect damages (see 1.8)—is unpromising, as it dooms you to drawing boundaries on the slippery, fact-specific slope from direct causation to indirect.
- 1.18** In the case of a sale, one could address special circumstances with the two sentences below, in addition to the sentence proposed in 1.14. The first sentence is intended to establish at signing, for all to see, whether the buyer is subject to special circumstances, instead of having a disgruntled buyer subsequently claim special circumstances. If the buyer is aware of special circumstances, it could either retain the right to bring a claim for damages relating to those special circumstances, or it could waive that right. The latter option is accomplished by the text in brackets within brackets in the second sentence.

The Buyer states that [except as described in section X,] it has no knowledge of any special circumstances to which it is subject that would render reasonably foreseeable any damages that otherwise would not have been reasonably foreseeable. The Buyer acknowledges that it follows from the previous sentence that the Buyer has no basis for bringing a claim against the Seller for damages arising from special circumstances [, except for those described in section X [, and the Buyer hereby waives any right to bring a claim against the Seller for damages arising from the special circumstances described in section X]].

- 1.19** Here's an example of how one might describe a given set of special circumstances:

In connection with the Seller's obligation to deliver units of the Goods to the Buyer on schedule in accordance with section 6, the Seller acknowledges that the Buyer has entered into contracts with its own customers that impose penalties on the Buyer for late delivery and that if the Seller is late in delivering units of the Goods to the Buyer, that could cause the Buyer to be liable for those penalties.

- 1.20** And here's a final limitation-of-liability option: a buyer might be more willing to live with a limited range of damages if it's entitled to liquidated damages.