NOT ALL IS LOST – EXPRESS TERMS NEEDED TO EXCLUDE CLAIMS FOR WASTED EXPENDITURE

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"Parties who wish to exclude claims for wasted expenditure must do so in clear and express terms."

In Soteria Insurance Limited (formerly CIS General Insurance Limited) v IBM United Kingdom Limited [2022] EWCA Civ 440, the UK Court of Appeal has given valuable guidance on the construction of exclusion and liability clauses. The decision makes clear that a claim for wasted expenditure is a distinct head of loss from a claim for loss of profits. The practical impact is that parties who wish to exclude claims for wasted expenditure must do so in clear and express terms. Mere reliance on a general exclusion for loss of profits will not suffice.

BACKGROUND

In 2015, CIS General Insurance Limited ("CISGIL") contracted with IBM under a Master Services Agreement ("MSA") for a new IT system. In 2017, CISGIL disputed an invoice ("AG 5 Invoice") from IBM and refused to pay until the issue was resolved. As a consequence, IBM purported to terminate the contract. CISGIL alleged that IBM had wrongfully repudiated the contract and sought £132m in damages for wasted expenditure flowing from the repudiation. It also sought damages for breach of warranty and delay.

Clause 23.3 of the MSA provided that:

"*Subject to clause 23.2 and 23.4, neither party shall be liable to the other or any third party for any Losses arising under and/or in connection with this Agreement (whether in contract, tort (including negligence), breach of statutory or otherwise) which are indirect or consequential Losses, or for loss of profit, revenue, savings (including anticipated savings), data (save as set out in clause 24.4(d)), goodwill, reputation (in all cases whether direct or indirect)…*"

Schedule 1 to the MSA defined "*losses*" as: "*All losses, liabilities, damages, costs and expenses including reasonable legal fees on a solicitors/client basis and disbursements and reasonable costs of investigation, litigation settlement, judgment, interest*".

FIRST INSTANCE DECISION

"Loss of profit/revenue/savings claims are difficult for the potential contract breaker to estimate in advance."

Mrs Justice O'Farrell held that CISGIL had disputed the AG 5 Invoice in good faith and as a result IBM could not rely on the non-payment of that invoice to justify termination. Although CIGSIL had established a claim for wasted expenditure, the judge held that this was just an alternative way of framing the loss of the bargain suffered by CISGIL. It did not change the characteristics of the losses being savings, revenues and profits that would have been achieved had the IT system been successfully implemented. Therefore, CISGIL's claim for wasted expenditure was excluded under clause 23.3.

COURT OF APPEAL DECISION

The Court of Appeal dealt with a number of issues on appeal, including the extent to which IBM had repudiated the contract. This update deals with the primary issue of interpretation of clause 23.3. IBM contended that this clause excluded CISGIL's right to make any claim for wasted expenditure.

The Court of Appeal allowed the appeal. It concluded that clause 23.3 did not preclude CISGIL from recovering its claims for wasted expenditure following IBM's repudiation of the MSA. The key reasons were:

"It made commercial sense that whilst a speculative loss was excluded by clause 23.3, wasted expenditure was not."

- "*losses*" were defined widely and carved out specific types of loss in respect of which liability was excluded, including "*loss of profit, revenue [or] savings*". Wasted expenditure was not expressly excluded, nor did it fall within the natural and ordinary meaning of loss of profit, revenue or savings. The words were "*simply not there*". The Court observed that the reported cases demonstrated that where the parties wanted claims for wasted expenditure to fall within an exclusion clause, they had spelled that out expressly;
- loss of profit/revenue/savings claims are difficult for the potential contract breaker to estimate in advance. Because of their speculative nature, these types of losses are routinely excluded by clauses like clause 23.3. A claim for wasted expenditure on the other hand is a "*pure accounting exercise*" and precisely ascertainable. Accordingly, it made commercial sense that whilst a speculative loss was excluded by clause 23.3, wasted expenditure was not; and
- the loss of bargain was principally represented by the loss of the IT system itself. It was not, as IBM contended, comprised solely in the savings, revenues and profit that would have been achieved by CISGIL had the IT system been successfully implemented. While a claim for wasted expenditure was a different way of calculating the damages for loss of the bargain, it was not a way of assessing or claiming lost profits. This, according to the court, was "*an unjustified leap of reasoning*".

"It would be the opposite of providing the clarity required to construe an exclusion clause."

It is interesting to note that Mrs Justice O'Farrell had previously dealt with this issue in *The Royal Devon and Exeter NHS Foundation Trust v ATOS IT Services UK Ltd [2017] EWHC 2197 (TCC)*, in which she came to a different conclusion. In that case, the claimant had entered into a contract for the supply and implementation of an electronic document management system and associated services. As in the present case, this was not achieved and the contract was terminated. The claimant sought damages on a wasted expenditure basis. The contract contained a clause which excluded liability for "*loss of profits, or of business, or of revenue, … or of anticipated savings*". Mrs Justice O'Farrell held that this did not exclude the claim for wasted expenditure.

In the Soteria judgment, she sought to distinguish the Royal Devon case on the basis that the "*loss suffered [in the latter] was non-pecuniary benefit that was not caught by the exclusion*". The Court of Appeal found that although Mrs Justice O'Farrell's finding in Royal Devon was correct that wasted expenditure was recoverable in principle, her reasoning that this was only because such expenditure gave rise to a non-pecuniary benefit was unsound. It would result in the same words in the same contract meaning something completely different, depending on the identity of the employer and whether it was a profit-making company or not. It would be the opposite of providing the clarity required to construe an exclusion clause.

CONCLUSION

The main take away from this is decision is reiteration of the principle that the more valuable the right, the clearer the language of any exclusion clause will need to be; the more extreme the consequences, the more stringent the court must be before construing the clause in a way which allows the contract breaker to avoid liability for non-performance. A party who wishes to exclude liability for wasted expenditure should make express reference to that head of loss and to avoid any residual uncertainty the parties should set out an agreed definition of wasted expenditure.

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