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Benjamin Geva

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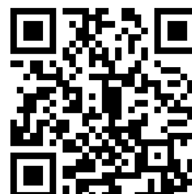

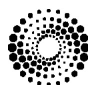

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All Is *Not* Lost: A Consequential Damages Exclusion May Not Preclude Lost Profits Under New York Law

Christopher M. Caparelli[*]

The New York Court of Appeals, the state's highest court, held in a 4 to 3 decision earlier this year that a plaintiff could recover lost profits for a breach of contract — even though the contract barred consequential and special damages — because the plaintiff's lost profits were general damages. The decision in *Biotronik, A.G. v. Conor Medsystems Ireland, Ltd.*[1] is noteworthy because lost profits, with few exceptions, are typically considered consequential damages.[2] Historically, the limited circumstances in which New York courts have regarded a lost profits claim as one for general damages almost always involved sellers whose anticipated profits were spelled out in the contract. The *Biotronik* case is only the second time — and the first since 1920 — that the Court of Appeals has concluded that a *buyer's* lost profits constituted a claim for general, not consequential, damages.

The *Biotronik* majority observed that the "distinction at the heart of these cases is whether the lost profits flowed directly from the contract itself or were, instead, the result of a separate agreement" with a third party.[3] Despite the distinction, the Court held that lost profits from the resale of goods to third parties may be general damages under certain contracts. Disavowing a "bright line rule," the *Biotronik* decision makes clear that a "case-specific approach" focusing on the "nature of the agreement" is required to determine whether a claim for lost profits is properly characterized as general or consequential damages.[4]

1. GENERAL VS. CONSEQUENTIAL DAMAGES UNDER NEW YORK LAW

General damages are the "natural and probable consequence"[5] of a breach of contract and include "money that the breaching party agreed to pay under the con-

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* The author is Counsel in the Litigation Department at Torys LLP in the firm's New York office. The author would like to thank David Wawro for his valued comments and insight.

1 22 N.Y.3d 799 (2014) [*Biotronik 2014*].

2 *Biotronik, A.G. v. Conor Medsys. Ireland, Ltd.*, 33 Misc. 3d 1219(A), 2011 WL 5385980 (N.Y. Sup. 2011) at *12 [*Biotronik 2011*], quoting *Yenrab, Inc. v. 794 Linden Realty, LLC*, 68 A.D.3d 755 (N.Y. App. Div. 2009) at 759.

3 *Biotronik 2014*, at 808. The distinction between general and consequential damages was articulated in New York long ago in *Masterton & Smith v. Mayor of Brooklyn*, 7 Hill 61, 68-69 (N.Y. Sup. Ct. 1845).

4 *Biotronik 2014*, *supra* note 1 at 808.

5 *Kenford Co. v. County of Erie*, 73 N.Y.2d 312 (1989) at 319 [*Kenford II*].

tract."[6] General damages are said to flow directly from the breach of contract.[7] A buyer's general damages for breach of a supply contract are typically measured as the difference between the market price and the price the buyer would have paid under the contract.

Consequential damages, on the other hand, are "indirect and compensate for additional losses incurred as a result of the breach."[8] A loss of anticipated profits from collateral business arrangements, such as from the expected resale of goods to be acquired pursuant to a supply contract, is a common example of consequential damages.[9]

The distinction between general and consequential damages is important for two reasons. First, the standard of proof for consequential damages is higher, requiring the non-breaching party to demonstrate that (1) the breach, with certainty, caused the damages, (2) the amount of the loss is capable of proof with reasonable certainty, and (3) the damages were fairly within the contemplation of the parties.[10] General damages require only a "reasonable estimate" of the amount when a breach is proven.[11]

Second, contracts often disclaim, as in *Biotronik*, a breaching party's liability for consequential and special damages.

2. HISTORY OF THE CASE

The *Biotronik* decision concerned an exclusive distribution agreement, governed by New York law, between plaintiff Biotronik, A.G., a distributor of medical devices, and defendant Conor Medsystems Ireland, Ltd., the developer and manufacturer of CoStar, a coronary stent. The agreement designated Biotronik as the exclusive worldwide distributor of CoStar except in the United States and certain other countries. The term of the agreement, signed in May 2004, ended on December 31, 2007, with an automatic one-year extension unless a party opted out of the extension by giving notice before July 1, 2007. Conor could also terminate the agreement at any time in the event it recalled CoStar from the market. Conor was obligated to reimburse Biotronik for its direct costs and expenses incurred due to a recall.[12]

During the contract term, Conor was obligated to supply, and Biotronik to purchase, a minimum quantity of the stents each calendar quarter. Biotronik agreed to pay Conor a "Minimum Transfer Price" for the stents each quarter on the basis

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6 *Tractebel Energy Marketing, Inc. v. AEP Power Marketing, Inc.*, 487 F.3d 89 (2d Cir. 2007) at 109 [*Tractebel*] *citing American List Corp. v. U.S. News & World Report*, 75 N.Y.2d 38 (1989) at 42 [*American List*].

7 *American List*, *ibid.* at 42-43.

8 *Biotronik 2011*, *supra* note 2 at *12, *quoting Appliance Giant, Inc. v. Columbia 90 Assoc., LLC*, 8 A.D.3d 932 (N.Y. App. Div. 2004) at 934.

9 *Biotronik, A.G. v. Conor Medsys. Ireland, Ltd.*, 95 A.D.3d 724 (N.Y. App. Div. 2012) at 725 [*Biotronik 2012*], *citing* N.Y. U.C.C. §2-715(2)(a); reversed 2014 WL 1237514 (2014).

10 *Kenford Co. v. County of Erie*, 67 N.Y.2d 257 (1986) at 261 [*Kenford I*].

11 *Tractebel*, *supra* note 6 at 110-11.

12 *Biotronik 2014*, *supra* note 1 at 802–04.

of the prior quarter's net sales. Above the minimum quantity, Biotronik agreed to pay Conor a price based on a percentage of Biotronik's average resale price: 61% for direct sales and 75% for indirect sales through Biotronik's sub-distributors. Biotronik had no obligation to resell any specific quantities of the stents or to resell them at a specific price. Moreover, during the term of the agreement, Conor had no payment obligations to Biotronik. Biotronik's profits, if any, were dictated by the revenue Biotronik generated from its sales of CoStar stents to third-party customers minus its costs to make those sales (including the price it paid to Conor).[13]

In the event of a breach, the distribution agreement allowed only general damages:

> Neither party shall be liable to the other for any indirect, special, consequential, incidental, or punitive damages with respect to any claim arising out of this agreement (including without limitation its performance or breach of this agreement) for any reason.[14]

In May 2007, prior to the end of the agreement's term, Conor recalled the CoStar stent and terminated the distribution agreement with Biotronik. (Perhaps not coincidentally, Conor recently had been acquired by Johnson & Johnson, which manufactured and marketed competing coronary stents). Conor paid Biotronik €8.32 million and an additional 20% handling fee to reimburse Biotronik for the stents remaining in inventory and its costs associated with the recall.[15]

Biotronik sued Conor, alleging that Conor's decision to recall CoStar and remove it from the market breached the distribution agreement. Biotronik claimed damages of over $100 million (later scaled back to $85 million), which it attributed to the loss of anticipated profits from sales of the CoStar stent through the end of the extended contract term. Biotronik argued that its lost profits claim constituted general damages not precluded by the agreement's damages limitation because its profits were built into the agreement's pricing formula. Therefore, according to Biotronik, its loss of profits was the direct result of Conor's refusal to meet its supply obligations.[16]

The New York City trial court disagreed and dismissed the lawsuit because it concluded that Biotronik's lost profits were consequential damages barred by the parties' agreement. The trial court observed that none of the cases Biotronik cited for support "involve[d] the lost profits on future sales of a product to third par-

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13 *Ibid.* at 803. *See also ibid.*, at 814–16 (Read, J. dissenting).

14 *Ibid.* at 803.

15 *Ibid.* at 804.

16 *Ibid.* at 808-09. *See also ibid.* at 810-11 (Read, J. dissenting).

ties."[17] "They merely stand for the proposition that a party to a contract may recover the money that the breaching party agreed to pay under the contract . . ."[18]

The trial court also considered Article 2 of the *Uniform Commercial Code* ("UCC"), because it applies to contracts for the sale of goods. In particular, UCC §2-715(2)(a) addresses a buyer's consequential damages resulting from a seller's breach."[19] Official Comment 6 to this UCC provision makes clear that, "[i]n the case of sale of wares to one in the business of reselling them," a loss resulting from the inability to resell the goods fits within the rule. According to the trial court, therefore, "this section squarely places a buyer's lost profits from a seller's breach of an agreement to supply those goods within the realm of consequential damages."[20] In other words, a buyer's lost profits from the resale of goods, like Biotronik's resale of CoStar stents, are consequential damages within the meaning of UCC §2-715(2)(a), not general damages.

A five-justice panel of the intermediate appellate court unanimously affirmed the trial court's dismissal of Biotronik's lost profits claim.[21] Also citing UCC §2-715(2)(a), the appeals court held that "a plaintiff suing to recover profits that it would have made by reselling the defendant's goods to third parties, as is the case here, is seeking consequential damages."[22] Distinguishing Biotronik's claim, the court noted that lost profits "only constitute general damages where the non-breaching party seeks to recover money owed directly by the breaching party under the parties' contract."[23]

In a sharply divided 4-3 decision, the Court of Appeals reversed, holding that "damages must be evaluated within the context of the agreement, and that, under the parties' exclusive distribution agreement, the lost profits constitute general, not consequential, damages."[24]

3. THE COURT OF APPEALS' ANALYSIS

The Court of Appeals began with the premise that "[t]he agreement was not a simple resale contract, where one party buys a product at a set price to sell at whatever the market may bear."[25] Rather, the agreement included target volumes and a formula for determining the price Biotronik paid Conor for the CoStar stents

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[17] *Biotronik 2011*, *supra* note 2 at *13. Biotronik had relied on *Masterton*, *supra* note 3 at 69 (seller of marble pursuant to a breached supply contract awarded the difference between the contract's purchase price and seller's cost to procure the marble); *American List*, *supra* note 6 at 38 (seller of mailing lists awarded "lost future profits" that were incorporated in a schedule annexed to the breached contract); and *Tractebel*, *supra* note 6 at 109 (seller of electricity pursuant to long-term supply contract awarded lost profits where contract required minimum purchases at stipulated prices).

[18] *Biotronik 2011*, *supra* note 2 at *13.

[19] N.Y.U.C.C. §2-715(2)(a).

[20] *Biotronik 2011*, *supra* note 2 at *14.

[21] *Biotronik 2012*, *supra* note 9 at 724.

[22] *Ibid.* at 725.

[23] *Ibid.* at 726.

[24] *Biotronik 2014*, *supra* note 1 at 805.

[25] *Ibid.* at 803.

based on Biotronik's actual sales and resale prices. Noting that both parties depended on the device's resale for their respective payments, the majority concluded that "the agreement reflects an arrangement significantly different from a situation where the buyer's resale to a third party is independent of the underlying agreement."[26] The court likened the agreement to a "quasi-joint venture."[27]

By doing so, the Court of Appeals did not accept that UCC §2-715(2)(a) dictated the conclusion that Biotronik's lost profits were consequential damages. The court instead examined the few cases in New York state and federal courts that previously found lost profits to constitute general damages. In particular, the court reached back to its only reported decision, not cited by the trial or appellate court, in which it held that a buyer's claim for lost profits could be treated as general damages: *Orester v. Dayton Rubber Mfg. Co.*[28] *Orester* concerned an exclusive distribution agreement to market and sell the defendant's tires in Syracuse, New York. The defendant agreed to manufacture, sell and deliver tires to the plaintiff at a reduced price for resale in Syracuse. The plaintiff, in turn, agreed to "aggressively push" the sale of tires, provide a showroom and carry a sufficient supply of tires in stock.[29] After the plaintiff had bought and resold 200 tires, the defendant did not deliver an additional 100 tires ordered by the plaintiff. The *Orester* court, expressly stating that it was not dealing with collateral arrangements or consequential damages, permitted the plaintiff to seek its lost profits as general damages and remanded the case for a new trial.

The *Biotronik* dissent criticized the majority's reliance on *Orester* for two reasons. First, the majority overlooked *Orester*'s holding that lost profits are an appropriate measure of general damages *only* when there is no other available method to calculate them.[30] In a typical case, the buyer's damages would be measured by the difference between the market and contract prices.[31] Because the plaintiff in *Orester* was the lone seller of the defendant's tires in Syracuse, however, there was no market price after the defendant breached the parties' agreement. In the absence of a market price, the Court observed that the plaintiff might purchase the defendant's tires from outside Syracuse, in which case his damages would be the difference between the contract price and the price he paid for the tires plus transportation charges to Syracuse.[32] If the tires were not available outside of Syracuse, the court remarked that the plaintiff could purchase substitute tires to resell, in which case his damages would be the difference between the sales price of the substitute and the contract price. Only if none of those measures was practicable, the *Orester* court concluded that the plaintiff "may prove the ordinary and usual net profits

26 *Ibid.* at 809-10.
27 *Ibid.* at 810, note 7.
28 228 N.Y. 134 (1920) [*Orester*].
29 *Ibid.* at 136.
30 *Biotronik 2014*, *supra* note 1 at 821 (Read, J. dissenting).
31 *Orester*, *supra* note 28 at 137.
32 *Orester*, *supra* note 28 at 138.

resulting from the business conducted in the ordinary and usual way, which he has lost by reason of such breach."[33]

The *Biotronik* dissent also rejected the majority's reliance on *Orester* because it preceded New York's adoption of UCC Article 2 in 1964. "[W]hile *Orester*'s holding as to the *measure* or *availability* of lost profits may still be applicable, modern law now locates these principles firmly under the rubric of consequential damages" (emphasis in original).[34] The *Orester* court's approval of lost profits as a measure of general damages "if the other tests fail,"[35] was consistent with New York's UCC predecessor, the *Uniform Sales Act*.[36] The proposition that lost profits were a last resort in measuring a buyer's general damages for a seller's breach under pre-UCC law was confirmed by the Second Circuit in *Murarka v. Bachrack Bros., Inc.*[37] "[T]he plaintiffs' loss of profits constituted general damages recoverable under [the *Uniform Sales Act*] because there was no available market."[38]

The Court of Appeals also considered its decision in *American List Corp. v. U.S. News & World Report* and the Second Circuit's decision in *Tractebel Energy Marketing, Inc. v. AEP Power Marketing, Inc.*, both of which characterized lost profits as general damages.[39] Unlike *Orester*, however, those cases concerned a seller's damages due to the buyer's breach of contract and neither case cited *Orester* for support. *American List* concerned a 10-year contract for the defendant's rental of mailing lists compiled by the plaintiff.[40] The defendant, seeking to expand its circulation with college students, agreed to finance the plaintiff's start-up costs to gather college students' addresses by paying higher fees for the first five years. Moreover, the agreement included a schedule, reflecting the "cost of this joint venture," specifying the plaintiff's estimated annual profits and losses over the course of the agreement.[41] In fact, the schedule expressly stated a sum, over $3 million, which the defendant agreed to pay the plaintiff during the 10-year term. When the defendant terminated the contract after 18 months, the plaintiff sought to recover the scheduled payments for the remaining term. Therefore, the Court of Appeals concluded, the plaintiff's lost profits were general damages "flowing as a natural and probable consequence of the breach."[42]

Tractebel involved a contract for the supply of energy over a twenty-year period.[43] The counterclaim, plaintiff AEP, agreed to supply energy to the counterclaim defendant, Tractebel which, in turn, agreed to take a minimum amount and

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33 *Ibid.* at 138-39.

34 *Biotronik 2014*, *supra* note 1 at 821 (Read, J. dissenting).

35 *Orester*, *supra* note 28 at 139.

36 *Biotronik 2014*, *supra* note 1 at 819 (Read, J. dissenting).

37 *Ibid.* at 819-20, *citing* 215 F.2d 547 (2d Cir. 1954).

38 *Murarka*. *supra* note 37 at 554-55, *citing Orester*, *supra* note 28 at 137–39.

39 *Biotronik 2014*, *supra* note 1 at 807–09. *See also American List*, *supra* note 6 at 43-44; *Tractebel*, *supra* note 6 at 109-10.

40 *American List*, *supra* note 6 at 41.

41 *Ibid.* at 43.

42 *Ibid.* at 43-44.

43 *Tractebel*, *supra* note 6 at 92-93.

make payments at prices stipulated in the agreement. Due to both a delay in the plaintiff's ability to deliver energy to the defendant and the subsequent collapse of the energy market, the defendant repudiated the contract. The plaintiff, the seller in the arrangement, sought its lost profits pursuant to the contract's termination payment provision, which defined such payment to include the plaintiff's losses resulting from the termination less the expenses it saved. Citing *American List*, the Second Circuit remarked that "when the non-breaching party seeks only to recover money that the breaching party agreed to pay under the contract, the damages sought are general damages."[44] Because the plaintiff sought only what it had bargained for, that is, its profit from the defendant's payments over 20 years, the court held that its claim was for general damages.[45]

Because *American List* and *Tractebel* did not concern contracts for the sale of goods, neither case implicated Article 2 of the UCC. The holdings of those decisions, however, are consistent with UCC §2-708, which addresses a seller's damages for the buyer's breach of contract. In contrast with UCC §2-715, which categorizes a buyer's lost profits as consequential damages, a seller's lost profits are general damages when the difference between the market and contract prices is inadequate to put the seller in as good a position as performance would have done. Although UCC Article 2 reclassified a buyer's lost profits as consequential damages after *Orester*, that case's holding remains the same with respect to sellers. The result is logical because sellers, unlike buyers, anticipate a profit on performance of the contract, *viz.*, the receipt of money from the buyer.

The *Biotronik* dissent read *American List* and *Tractebel* to compel a conclusion that Biotronik's lost profits were consequential damages. The dissent emphasized the fact that, in *American List*, a schedule appended to and incorporated in the parties' agreement "set out the specific sums that U.S. News committed to pay American List for each of the ten years."[46] Under those circumstances, American List's lost profits were general damages because it "sought only to recover moneys which [U.S. News] undertook to pay under the contract."[47]

Tractebel, in turn, relied on *American List*, stating, "when the non-breaching party seeks only to recover money that the breaching party agreed to pay under the contract, the damages sought are general damages."[48] And, like *American List*, the plaintiff in *Tractebel* sought "only what it bargained for — the amount it would have profited on the payments [Tractebel] promised to make for the remaining years of the contract."[49]

The majority and dissent diverged, therefore, on whether Biotronik's lost profits from anticipated resales to third parties were moneys that Conor had agreed to pay under the contract. Yet, there was no dispute that "under no circumstance do the Agreement's pricing provisions require Conor (the breaching party) to pay any

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44 *Ibid.* at 109.

45 *Ibid.* at 110.

46 *Biotronik 2014*, *supra* note 1 at 811 (Read, J. dissenting).

47 *Ibid.* at 812, *quoting American List*, *supra* note 6 at 43.

48 *Tractebel*, *supra* note 6 at 109, *citing American List*, *supra* note 6 at 44.

49 *Tractebel*, *ibid.* at 110.

moneys to Biotronik (the non-breaching party)."[50] The majority contended that the dissent "places form over substance" and that the distinction between general and consequential damages "does not turn on which party actually takes out the checkbook at the end of the fiscal quarter."[51] The majority's view is difficult to square with Article 2 of the UCC, which does classify a seller's lost profits from the buyer's expected payments as general damages and a buyer's lost profits from the seller's breach as consequential damages.

Ultimately, the *Biotronik* court's holding that the plaintiff's profits flowed directly from the contract's pricing formula results from its view that the agreement was a "quasi-joint venture," similar in that regard to the contract in *American List*.[52] The dissent criticized the majority for accepting Biotronik's "creative" reading of the agreement's pricing formula remarking, "[c]reativity on this scale is no boon in the commercial world, 'where reliance, definiteness, and predictability are such important goals of the law itself, designed so that parties may intelligently negotiate and order their rights and duties.'"[53]

Because the court determined that Biotronik's lost profits were general damages, Biotronik's claim was not barred by the agreement's limitation of liability provision precluding consequential damages. On remand, the appellate court denied Conor's motion for summary judgment on grounds that it did not breach the contract (an issue the court did not reach in its earlier decision), and remanded the case to the trial court for a trial on liability and damages.[54]

4. CONCLUSION

The *Biotronik* case presents a unique set of facts in an area of New York law without extensive jurisprudence. As Justice Oliver Wendell Holmes, Jr. observed, "great cases, like hard cases, make bad law,"[55] and this adage appears apt in *Biotronik*.

Nevertheless, as a decision from New York's highest court, it constitutes the law in New York. Therefore, parties to New York-governed contracts intending to exclude lost profits cannot assume that the exclusion of consequential or special damages will suffice. They are advised, after *Biotronik*, to expressly exclude "lost profits."

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50 *Biotronik 2014*, *supra* note 1 at 816 (Read, J. dissenting).

51 *Ibid.* at 809.

52 *Ibid.* at 810 and note 7.

53 *Ibid.* at 823 (Read, J. dissenting), citing *Matter of Southeast Banking Corp.*, 93 N.Y.2d 178 (1999) at 184.

54 *Biotronik A.G. v. Conor Medsys. Ireland, Ltd.*, 117 A.D.3d 551 (N.Y. App. Div. 2014).

55 *Northern Secs. Co. v. U.S.*, 24 S. Ct. 436 (U.S. 1904) at 468 (Holmes, J. dissenting).